

Georgian National Energy and Water Supply

Regulatory Commission

Decision №38/2

September 2, 2020

Tbilisi

On Taking Preliminary Decision on Refusal of Certification of LLC “Georgian Gas Transportation Company” as the Natural Gas Transmission System Operator

Georgian National Energy and Water Supply Regulatory Commission (hereinafter - the Commission) held a public hearing on the application of LLC "Georgian Gas Transportation Company" concerning certification of the transmission system operator.

On June 10, 2021, LLC Georgian Gas Transportation Company (hereinafter - the Applicant) by the letter N1-1102 submitted to the Commission the application for certification as a transmission system operator (hereinafter - the Application) with supporting documentation.

The Commission reviewed the compliance of the submitted Application with the requirements of Article 78 of the General Administrative Code of Georgia, as well as the requirements of the Transmission System Operator Certification Rules approved by the Commission Resolution №9 of 27 March 2020 (hereinafter – Certification Rules). In addition, the documentation envisaged by Article 6 of the Certification Rules were enclosed to the Application, inter alia, the Unbundling Application of the Transmission System Operator the form of which is approved through Annex N1 of the Certification Rules and information on unbundling (according to the form approved through Annex N2) and completed Form for Independent System Operator (approved through Annex N4 of the Certification Rules). The agreement on lease of transmission system assets (main gas pipelines and related infrastructure) concluded between the Applicant and LLC Georgian Natural Gas Transmission Network Owner, was not submitted.

Based on the submitted documentation and information, the Commission initiated an assessment of the Applicant's compliance with the independence and unbundling requirements established by the Law of Georgia on Energy and Water Supply.

Legal Basis for Certification

In 2014, Georgia signed the Association Agreement between Georgia, on the one hand, and the European Union and the European Atomic Energy Community, and their Member States, on the other, which foresaw the obligation of the State to harmonize Georgian legislation with the European legal acts. On October 14, 2016, Georgia signed the Protocol on the Accession of Georgia to the Treaty Establishing the Energy Community (hereinafter - the Protocol), which was ratified by the Parliament of Georgia on April 21, 2017. The Protocol sets out the terms and conditions for transposition of the Energy Community legislation (*acquis communautaire*) into Georgian legislation.

On December 20, 2019, the Parliament of Georgia adopted the Law of Georgia on Energy and Water Supply (hereinafter - the Law), which entered into force on December 27, 2019. The Law sets out, *inter alia*, the obligation of certification of a transmission system operator, the rules, procedures, and deadlines for certification, as well as the regulatory power/authority of the Commission in the process of certification of a transmission system operator.

One of the core aims of the *acquis communautaire*, in particular of the Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 on common rules for the internal market in natural gas and repealing Directive 2003/55/EC (hereinafter - the Directive), is to ensure the proper implementation of the independence and unbundling of transmission system operators. Article 50 of the Law establishes the general rule for unbundling of the transmission system operator, while paragraph 3 of the same Article defines the authority of the Commission to approve the relevant normative act. Based on this, the Commission approved the Transmission System Operator Certification Rules by Resolution N9 of 27 March 2020, which sets out the procedure for unbundling of transmission system operators, including the list of documents and information to be submitted by the Applicant and the procedure and deadlines for reviewing the application by the Commission.

General information about the Applicant and the energy enterprises carrying out transmission activities

At the moment of submitting the Application to the Commission, the Applicant transports natural gas on the territory of Georgia based on the licenses issued by the Commission.

The Applicant is a limited liability company established under the Law of Georgia on Entrepreneurs, which provides natural gas transportation, (*inter alia* transit) throughout the territory of Georgia based on the natural gas transportation license (N^o004, series 22) issued by the decision N10/2 of the Commission of June 9, 2004. The validity term of the license was amended by the decision N21/1

of the Commission of December 10, 2009, and became permanent. Following paragraph 8 of Article 159, natural gas transportation licenses issued before the entry into force of this Law shall temporarily remain in force, and until the completion of unbundling under the procedures established by this Law, their holders shall continue providing services in respect of the transportation of natural gas, under the normative acts referred to in Article 168 of this Law, however in the case of the revocation of said licenses, following related normative acts adopted based on this Law. The Applicant possesses the assets required for the transportation of natural gas based on the N74-310811-01 agreement on lease of the main gas pipelines and related infrastructure of LLC Georgian Oil and Gas Corporation concluded with the JSC Georgian Oil and Gas Corporation on 31 August 2011.

The Applicant was established based on the minutes N1 of the General Meeting of Shareholders of JSC Georgian International Gas Corporation of December 28, 1999, which was registered in the Entrepreneurial Register by the decision of the Isani-Samgori District Court of Tbilisi city of December 30, 1999. JSC Georgian International Gas Corporation, which in turn was established on June 26, 1997, by the Ministry of State Property Management of Georgia, owned 100% of the shares of LLC Georgian Gas Transportation Company.

On April 6, 2006, the State, represented by the Ministry of Economic Development, established the LLC Georgian Oil and Gas Corporation, and 100% of the shares of JSC Georgian International Gas Corporation were incorporated in its chartered capital. Later, on October 4, 2006, JSC Georgian International Gas Corporation merged with LLC Georgian Oil and Gas Corporation, and as a result, LLC Georgian Oil and Gas Corporation became the owner of 100% of shares of LLC Georgian Gas Transportation Company.

Based on the Order N169 of the Minister of Energy and Natural Resources of Georgia of August 30, 2011, 100% of shares of LLC Georgian Gas Transportation Company was withdrawn from the chartered capital of LLC Georgian Oil and Gas Corporation and the State became a direct founding partner.

Based on the Resolution on amending the Decree N1051 of the President of Georgia of November 10, 2010 „on transfer of state-owned shares through direct transfer and with the management rights to the Ministry of Energy and Natural Resources of Georgia", also amendments to the Agreement of November 22, 2010 concluded between the Ministry of Economy and Sustainable Development and the Ministry of Energy of Georgia on transfer of state-owned shares, on September 21, 2011, on the basis of an agreement concluded between the Ministries of Economy and Sustainable Development of Georgia and the Ministry of Energy and Natural Resources of Georgia, 100% of the shares of LLC Georgian Gas Transportation Company was transferred to the Ministry of Energy and Natural Resources with the management right; except the liquidation and bankruptcy of the company, the legal encumbrance of the company's assets and the inclusion in the capital of the company of state-

owned property, the management of which, according to the Law of Georgia on State Property, was the competence of the owner (i.e. the Ministry of Economy and Sustainable Development).

According to the Law of Georgia on amending the Law of Georgia “on the Structure, Powers and Rules of Activities of the Government” the functions and authorities of the Ministry of Energy of Georgia were transferred to the Ministry of Economy and Sustainable Development of Georgia (hereinafter - the Ministry), which was considered the legal successor of the Ministry of Energy of Georgia. Accordingly, from the mentioned date, the ownership and management of 100% of the shares of LLC Georgian Gas Transportation Company has been carried out by the Ministry. According to the agreement concluded between LEPL National Agency of State Property and the Ministry, on May 22, 2019, amending the Agreement concluded between the Ministry of Economy and Sustainable Development of Georgia and the Ministry of Energy of Georgia on the transfer of state-owned shares, signed on November 22, 2010, as of today, 100% of the shares of the Applicant is owned by the State, which is represented by the LEPL National Agency for State Property, and the managing rights belong to the Ministry.

Unbundling of natural gas transmission system operator

a) Approval of unbundling plan of natural gas transmission system operator

According to Article. 44, paragraph 1 of the Law, the Government of Georgia takes a decision on unbundling model of transmission system operator; according to paragraph 2 of this Article, unbundling model of transmission system operator shall be ownership unbundling, regulated by Article 45 of the Law. Article 46, paragraph 1 of the Law states that the Commission is entitled to authorize independent system operator, as an exception, if the conditions stated in Article 44, paragraph 2 of the Law are on face. Article 46, paragraph 2 establishes the circumstances for the authorization of independent system operator.

Article 44 paragraph 1 of the Law establishes adoption procedure of the unbundling plan – The Commission, in agreement with Energy Community Secretariat, submits to the Government of Georgia unbundling model of the transmission system operator and the action plan for its implementation. Article 159 paragraph 4 of the Law promulgates the procedure for the review of the unbundling plan by the Commission. According to paragraph 2 subparagraph “b” of Article 159, within 9 months after adoption of the Certification Rules, the natural gas transportation licensee, shall develop the unbundling plan and submit it to the Ministry and the Commission. The unbundling plan shall include the suggested unbundling model, detailed measures and actions for its implementation, as well as the applicable deadlines. On March 25, 2021, through the Resolution N129, the Government of Georgia adopted “Unbundling Plan of the Natural Gas Transmission System Operator” (hereinafter – the Unbundling Plan).

b) Unbundling plan of the natural gas transmission system operator

According to Article 159 paragraph 5 of the Law, following the adoption of the Unbundling Plan by the Government of Georgia, the dispatch licensee, transmission licensee, transportation licensee or other energy company, which, according to the Unbundling Plan, will be granted the status of a transmission system operator or will be recognized as a transmission system owner, shall implement the Unbundling Plan and report to the Commission on the status of its implementation, in accordance with the conditions established by the Commission.

The Unbundling Plan states measures that shall be taken, namely:

- Registration/accounting and revaluation of the assets owned by JSC Georgian Oil and Gas Corporation, which are used for natural gas transmission activities and submit information to the Ministry; establishment of the new legal entity (transmission system owner) and assign this legal entity the ownership right to the assets which are used for natural gas transmission activities, through putting of these assets into the capital of the transmission system owner; also, ensuring of independence of the transmission system owner from the JSC Georgian Oil and Gas Corporation, at least in term of legal form, organizational structure and decision making, inter alia, through adoption of the charter of the transmission system owner;
- Development of the compliance program by the transmission system owner, which shall establish the measures to prevent discrimination, impact of JSC Georgian Oil and Gas Corporation upon the transmission system owner, regarding the issues related to the transmission network and shall provide sufficient monitoring **by the independent compliance officer** upon these issues;
- Development of the draft lease agreement by the transmission system owner and the Applicant that shall provide transfer of the transmission system assets to the Applicant (in order to perform functions of transmission system operator); the lease agreement shall grant the Applicant the rights of management, operation, maintenance and planning of the transmission system (except the infrastructural projects listed in the Annex 1 of the Unbundling Plan, that shall transfer to the Applicant upon their completion);
- Conclusion of the lease agreement mentioned in the paragraph 3.1.4 of the Unbundling Plan by the transmission system owner and the Applicant (that shall enter into force from January 1, 2022) and submission of it to the Commission, not later than June 10, 2021;
- According to the Article 45, paragraph 5, by August 9, 2021, on the basis of negotiations with the State institutions or other public entities, reallocation of the management rights of the enterprises that are under the managements of the Ministry, in order to prevent management of the undertakings that are related to the transmission, distribution, on the one hand and undertakings related to the generation/supply/trading – on the other hand, by the same State institution:

a) Undertakings that perform transmission activities:

a.a) LLC “Georgian Gas Transportation Company” – (100% of shares);

a.b) JSC “Georgian State Electrosystem” – (100% of shares);

a.c) JSC „United Energy System “Sakrusenergo” – (50% of shares);

b) Undertakings that perform generation/supply activities:

b.a) JSC „Georgian Oil and Gas Corporation“ – (100% of shares);

b.b) JSC „Electricity System Commercial Operator” – (100% of shares);

b.c) LLC „Enguri HPP“ – (100% of shares).

c) Implementation of the Unbundling Plan of Natural Gas Transmission System Operator

According to subparagraph 3.1.1.2 of the Unbundling Plan, JSC Georgian Oil and Gas Company founded LLC Georgian Natural Gas Transmission System Owner on April 29, 2021 (hereinafter – the Transmission System Owner) and transferred ownership right over the transmission system assets to it. According to the Charter of the Transmission System Owner, the main activities of the Transmission System Owner are performing the functions of the transmission network owner, established by the Law. These functions include but are not limited to: cooperation with the independent system operator, provision of information to the independent system operator to develop natural gas transmission system development plans and/or investment projects, provision of consent on financing these plans and projects by the third parties, the conclusion of the lease agreement with the transmission system operator (independent system operator), perform and monitor this agreement, in the framework of the competence established by the Law and the lease agreement, participate in decision-making related to the investments carried out by the independent system operator related to the natural gas transportation system.

The Applicant as well as the Transmission System Owner did not submit the compliance program to the Commission nor the information about the development of such plan.

The Applicant submitted the draft lease agreement to the Commission on July 2, 2021, by the letter N1-1241 (English version) and on July 8, 2021, by the letter N1-1258 (English and Georgian versions). In these letters, the Applicant mentioned the ongoing negotiations with the Transmission System Owner to conclude this agreement as well as about issues regarding which the parties did not achieve the consensus. One of such issues was the rent that shall be paid by the Applicant for using the transmission system assets. The Applicant asked the Commission for mediation between the parties to achieve consensus regarding the text of the agreement. In its turn, the Transmission System owner

applied to the Commission on July 7, 2021, by letter No.TNO/01-070721-1 and provided the position regarding the rent, inter alia, using the “arm's length” principle to calculate the rent; also, the Transmission System Owner stated that the assets to be transferred to the Applicant had to be evaluated according to their market value.

The Commission provided its position to the Applicant, the Transmission System Owner, JSC Georgian Oil, and Gas Corporation, and the Ministry, regarding the particular clauses of the lease agreement and the rent, on July 27, 2021, by the letter N1/09-16-5924. In this letter, the Commission also underlined the method of evaluation of natural gas transportation system assets as well as the necessity of correcting several clauses of the draft lease agreement. The Commission also indicated the clauses of the Charter of the Transmission System Owner that had to be corrected to provide compliance with the independence and unbundling requirements established by the Law and the Unbundling Plan. The Commission also underlined that the signed lease agreement had to be submitted to the Commission as soon as possible, otherwise the Commission would not be able to fulfill the functions established by the Law and the Unbundling Plan, in particular, to take the preliminary decision regarding certification of the transmission system operator. Despite all of the abovementioned circumstances, the lease agreement concluded between the Applicant and the Transmission System Owner had not been submitted to the Commission.

To fulfill the requirements established by Article 4, paragraph 2 of the “Electricity Transmission System Operator Unbundling Plan”, adopted by the Government of Georgia, through the Resolution N682 on December 2, 2020, the Minister of Economy and Sustainable Development of Georgia (hereinafter - the Minister) issued Order N1-1/521 on “Establishing a Different Rule for Assigning and Reallocation of the Functions among the Divisions of the Ministry of Economy and Sustainable Development of Georgia”. According to this Order, the Department of Energy Policy and Investments of the Ministry shall carry out the rights and obligations of the partner/shareholder of the Applicant, JSC UES Sakrusenergo, LLC Georgian Gas Transportation Company and JSC Energy Development Fund of Georgia, whereas the Department of Energy Reforms and International Relations of the Ministry shall carry out the rights and obligations of the partner/shareholder of JSC Electricity System Commercial Operator, JSC Georgian Oil and Gas Company and LLC Engurhesi HPP. The Applicant did not submit to the Commission any document or information that would prove taking any additional measure by the Ministry to implement paragraph 3.1.9 of the Unbundling Plan.

d) Compliance of Unbundling of the Transmission System Operator with the requirements of the Certification Rules

In order to establish compliance of unbundling of the Applicant with the requirements of the Certification Rules, the Commission examined the Application and accompanied documents submitted by the Applicant.

Pursuant to Article 6 paragraph "a" of the Certification Rules, the Applicant is obliged to submit to the Commission certified copies of the Applicant's corporate documents in accordance with the Laws of Georgia and an extract from the Registry of Enterprise and Non-Commercial Legal Entities, indicating the final beneficiary owner of the Applicant. The Applicant submitted the extract from the Registry of the Enterprises and Non-Commercial (Non-Profit) Legal Entities, which proves that the final beneficiary of 100% of the Applicant shares is the State, as well as the Charter of the Applicant.

According to paragraph „b“ of Article 6 of the Certification Rules, the Applicant shall submit to the Commission the list of licenses, permits, and/or other types of authorization for energy activities carried out by the Applicant in Georgia and/or other country and certified copies of the documents proving such authorization; according to the paragraph „c“ of the same Article, the Applicant shall submit to the Commission list of those energy activities which are not subject to the licensing, permitting and/or other type of authorization requirement, carried out by the Applicant in Georgia and/or other country, as well as a written justification about the legal basis for carrying out that type of activity. The Applicant submitted a list of the licenses it holds and also indicated that it doesn't carry out unlicensed energy activities.

Paragraphs “d”, “e”, and “f” of Article 6 of the Certification Rules oblige the Applicant to submit the information on shareholders/partners, privileged shareholders, and their voting rights, with a precise indication of the percentage of shares. This information was not provided by the Applicant since 100% of the shares of the Applicant are owned by the State.

According to paragraph „g“ of Article 6 of the Certification Rules, the Applicant shall submit to the Commission the list of energy sector participant undertakings which are under direct or indirect control of the applicant with precise indication of control method and relevant rights of the applicant; paragraph “f” of the same Article requires the Applicant to submit the list of energy sector participant undertakings which are not shareholders/partners of the Applicant and exercise direct or indirect control over the Applicant with a precise description of the control method and rights of relevant energy sector participants. According to the documentation submitted by the Applicant, 100% of its shares are owned by the State, and the rights and obligations of the shareholder are exercised by the Ministry based on the Agreement on Transfer of State-Owned Shares; 100% of the shares of the transmission network owner are owned by JSC Georgian Oil and Gas Corporation, 100% of the shares of which are owned by JSC Partnership Fund, and the shareholder rights and obligations are similarly exercised by the Ministry under the Agreement on Transfer of State-Owned Shares. JSC Georgian Oil and Gas Corporation carries out supply and trade of natural gas, as well as generation/supply of electricity through its subsidiaries (LLC Gardabani Thermal Power Plant, LLC Gardabani Thermal Power Plant 2 and LLC Gardabani Thermal Power Plant 3). At the same time, the State controls the energy enterprises carrying out transmission (JSC Georgian State Electrosystem, JSC UES Sakrusenergo), generation (LLC Enguri HPP, LLC Vardnili Cascade HPP) and trade (JSC Electricity

System Commercial Operator). As for the information referred to in paragraph “h” of Article 6 of the Certification Rules, list of the energy sector participant undertakings which are not shareholders/partners of the Applicant and exercise direct or indirect control over the Applicant - the Applicant indicated that it is not directly or indirectly controlled by any energy undertaking registered in Georgia and/or another country.

Under Paragraph „i“ of Article 6 of the Certification Rules, the Applicant shall submit the list of related undertakings with the description of the type of relationship between the Applicant and the linked undertaking, including the level of cooperation between the Applicant, and linked undertaking in the process of carrying out energy and/or other activities. The Applicant listed the following energy undertakings as the related undertakings: JSC Georgian Oil and Gas Corporation, JSC Georgian Energy Development Fund, LLC Enguri HPP, JSC Electricity System Commercial Operator, JSC Georgian State Electrosystem, JSC UES Sakrusenergo.

According to the Applicant, as well as the data available through the Registry of Enterprises and Non-Commercial (Non-Profit) Legal Entities of the LEPL - National Agency of Public Registry of Georgia, the relationship type is as follows: the State owns 100% of shares of LLC Enguri HPP, JSC Electricity System Commercial Operator, JSC Georgian State Electrosystem, JSC Georgian Energy Development Fund, and the owner of 100% of shares of JSC Georgian Oil and Gas Corporation is JSC Partnership Fund. The listed undertakings are directly managed by the Ministry that is indicated in the extract of LLC Enguri HPP from the Registry of Enterprises and Non-Commercial (Non-Profit) Legal Entities of the LEPL - National Agency of Public Registry of Georgia; in case of JSC Georgian Oil and Gas Corporation – in the Agreement between the Ministry of Energy and Natural Resources of Georgia and JSC Partnership Fund “On the Transfer of Ownership of the Shares owned by JSC Partnership Fund, concluded on August 31, 2012; in case of JSC Georgian Gas Transportation Company and JSC Georgian Energy Development Fund the managing rights of the Ministry are confirmed by the Agreement concluded on September 21, 2011 between the Ministry and the Ministry of Energy and Natural Resources of Georgia “On Amendment to the Agreement Between the Ministry of Economy and Sustainable Development and the Ministry of Energy and Natural Resources of Georgia on the Transfer of the Ownership of State-Owned Shares, signed on November 22, 2010”. JSC Partnership Fund, in its turn, is a legal entity of private law established under the Laws of Georgia and its portfolio includes large state-owned enterprises; its Supervisory Board is composed of members of the Government of Georgia, in particular, the Supervisory Board is chaired by the Prime Minister, and the members of the Board are the Minister of Regional Development and Infrastructure, the Minister of Environmental Protection and Agriculture, the Minister of Economy and Sustainable Development, and the Minister of Finance.

In the part of the related enterprises, the Applicant also indicated the owner of the transmission system network, 100% of the shares of which are owned by JSC Georgian Oil and Gas Corporation;

GOGC Trading SA, a company established in Switzerland and wholly-owned by JSC Georgian Oil and Gas Corporation; LLC Gardabani Thermal Power Plant, 50.908% shares of which is owned by JSC Georgian Oil and Gas Corporation, and the rest by JSC Partnership Fund; LLC Gardabani Thermal Power Plant 2 and LLC Gardabani Thermal Power Plant 3, 100% of the shares of both are owned by JSC Georgian Oil and Gas Corporation.

In the part of the related enterprises, the Applicant also submitted a list of other related enterprises with which the Applicant has concluded natural gas transportation contracts, and accordingly, they are the users of the system. The annex also indicates the energy activities carried out by the related enterprises.

The applicant also referred to LLC InterGlass-Georgia as a related enterprise, which does not carry out energy activities and in the chartered capital of which the Applicant owns 40% of the shares and exercises the right of a partner following the Charter. The Applicant submitted an extract from the Register of Entrepreneurs and Non-Entrepreneurial (Non-Commercial) Legal Entities of LLC Inter Glass-Georgia.

Paragraph „j“ of Article 6 of the Certification Rules obliges the Applicant to submit the list of acquired licenses, permits, and/or other types of authorization for energy activities in Georgia by the Applicant's shareholders/partners, energy sector participants envisaged in paragraph “g” and “h” and linked energy undertakings envisaged in paragraph “i” of this Article and certified copies attesting relevant authority in compliance to the legislation in force; and paragraph „k“ of the same Article provides that the Applicant shall submit the list of energy activities in Georgia by the Applicant's shareholders/partners, energy sector participants envisaged in paragraph “g” and “h” and linked energy undertakings envisaged in paragraph “i” of this Article which are not subject of a license, permit, and/or other types of authorization and a written justification about the legal basis for carrying out that type of activities. The materials submitted by the Applicant contains comprehensive information on the energy activities carried out by the linked undertakings. As for the legal basis for carrying out of these energy activities, taking into consideration that all related documents are possessed by the Commission, collection of these documents and submitting certified copies by the Applicant was not required. As for the licenses issued by another body, the Applicant submitted a license issued by LEPL State Agency of Oil and Gas to LLC Bago.

Paragraph „l“ of Article 6 of the Certification Rules obliges the Applicant to submit the Agreement/Charter of the Applicant's shareholders/partners. The Applicant has submitted the Charter defining the legal form of the Applicant, its activities, main goals and objectives, as well as the competencies of the management bodies of the Applicant. According to Article 6 of the Charter, the management bodies of the Applicant are the General Meeting of Partners and the General Director. According to the first paragraph of Article 7 of the Charter, the General Meeting of Partners is the

highest governing body of the company. As for the management and representation authority - it is exercised by the General Director, who acts and makes decisions within the powers defined by the Charter, the Laws of Georgia, and the General Meeting of Partners. According to the delegation act issued by the general director in accordance with the legislation of Georgia, the representative powers of the Applicant may be delegated to another person. According to the Charter, control over the activities of the Applicant is exercised by the General Meeting of Partners.

Paragraph „m“ of Article 6 of the Certification Rules obliges the Applicant to submit the copies of internal organizational acts regulating the activity of collegial bodies (supervisory board, person/persons with managerial and/or representative authority) of the Applicant, including copies of acts determining their right of representation. According to paragraph „n“ of the same Article, the Applicant shall submit the list of members of the Applicant’s collegial body (supervisory board, person/persons with managerial and/or representative authority, managing council), as well as the list of members of the collegial body of shareholders/partners, energy sector participants envisaged by paragraph “g” and “h” and linked energy undertakings envisaged by paragraph “i” of this Article. The Applicant indicated that it has no collegial bodies and the person authorized to represent the Applicant is the General Director. The Applicant also submitted the list of members of the collegial bodies of the related undertakings. According to the information provided, the General Director and the persons to whom the management/representation powers are delegated, are not represented in the collegial bodies of the linked enterprises and do not hold any managerial/representative positions.

Paragraphs „o“ and “p” of Article 6 of the Certification Rules require the Applicant to submit the decision of the general meeting of the Applicant’s shareholders/partners or other authorized body (including information on voting) based on which the members of collegial body (supervisory board and/or managing council or representative body) were elected or appointed, and the decision of the general meeting or other collegial body (supervisory board) of the Applicant based on which authorized persons of the Applicant were appointed on the respective managerial positions. The Applicant submitted Order NoK-5/38 of the Minister of Economy and Sustainable Development of Georgia of 9 December, 2019 appointing Mikheil Shalamberidze to the position of General Director of LLC Georgian Gas Transportation Company.

According to paragraph „q“ of Article 6 of the Certification Rules, the Applicant is required to submit the information about authorized persons on managerial position and employees, who are assigned organizational (operational/business, financial) and administrative (management/decision-making) functions of the Applicant and/or information about mandated other persons to whom the above-mentioned functions are assigned. Based on subparagraph „q.a” of Article 6, according to the order N39 of the General Director of the Applicant, of June 15, 2020, specific powers of management/representation are delegated to the deputy general directors, chief engineer, and heads of the relevant departments. The Applicant failed to submit the information provided in subparagraph

„q.b” of Article 6 of the Certification Rules, on any other professional and/or commercial activities of the persons authorized to manage the Applicant. According to the statements submitted by the Applicant by subparagraph "q.c" on conflict of interest, the deputy general directors, chief engineer, and heads of the relevant departments, who have been assigned the powers of management/representation based on the above-mentioned powers of attorney, confirm that they do not participate in the activities of energy sector participants related to electricity and/or natural gas generation, distribution, supply and trading activities and are not presented in the structures of such undertakings.

According to paragraph „r“ of Article 6 of the Certification Rules, the Applicant is required to submit the copies of internal organizational acts and procedural rules that ensure confidentiality of commercially sensitive information in compliance to the Georgian legislation in force and forbids the dissemination of this information to those participants of energy sector, who carry out electricity and/or natural gas generation, distribution, supply and trading activities. The Applicant submitted Order N110 of the General Director of 25 May 2021, "on the protection of the confidentiality of information containing commercial secrets of LLC Gas Transportation Company”, according to which all employees of the Applicant are obliged, through the duration of the employment contract, as well as in case of its termination, to protect the information containing commercial secrets, about which the employee learned during his employment in the company; and not to disclose such information to enterprises engaged in the generation, distribution, supply and trade of electricity and/or natural gas. For this Order “the information containing commercial secrets” implies the information that has not been made publicly available by the Applicant, relating to technical, commercial, and financial matters/issues of the Applicant's activities, also information on a plan, formula, process, or means of a commercial value, or any other information used for rendering services, and/or is a novelty or a significant result of technical activity, as well as other information that may cause harm to the Applicant if disclosed and impede fair competition on the energy market. The order also stipulates the obligation to notify the Applicant's staff by e-mail.

Paragraph "s" of Article 6 of the Certification Rules, obliges the Applicant to provide information on the Applicant's management and those employees who had been transferred from other energy enterprises performing electricity/natural gas generation, distribution, supply activities or trading, during the last 6 months prior submission of the Certification Application. The Applicant indicated that during the last 6 months before submission of the Certification Application, none of the above-listed persons/employees have been transferred from other energy enterprises performing electricity/natural gas generation, distribution, supply activities, or trading.

In addition, the Applicant submitted Unbundling Application of the Transmission System Operator the form of which is approved through Annex N1 of the Certification Rules and information

on unbundling (according to the form approved through Annex N2) and completed Form of Independent System Operator (approved through Annex N4 of the Certification Rules).

Legal Assessment

Having examined the documents and information submitted by the Applicant, the Commission evaluated compliance of the Applicant with the requirements of the independent system operator established by the Law and the Unbundling Plan.

According to Article 42 paragraph 1 of the Law, transmission is an activity of public interest which encompasses transportation of electricity or natural gas through the transmission network as well as the operation, maintenance and development under economic conditions of the transmission network, and other related activities necessary for secure, reliable and efficient functioning of the electricity and natural gas systems of Georgia. According to paragraph 3 of the same Article, while carrying its duties and fulfilling its tasks, the transmission system operator shall be independent from any other energy activities, namely production, distribution, supply and trade, and related commercial interests.

Article 43, paragraph 1 of the Law states that transmission system operator shall be authorized by the Commission through issuing a transmission license; according to paragraph 2 of the same Article, transmission license shall be granted only to the transmission system operator that is certified in accordance with Article 50 of the Law.

According to Article 46, paragraph 2 of the Law, the authorization of an independent system operator may be granted only if:

a) candidate for an independent system operator meets the requirements set in Article 45 paragraph 2 of this Law;

b) candidate for an independent system operator has the necessary financial, technical, physical and human resources to fulfill the functions and obligations provided in Articles 51 and 52 of this Law;

c) candidate for an independent system operator undertakes to implement a ten-year transmission network development plan in accordance with Article 53 of this Law;

d) transmission system owner claims that he has proper ability to fulfill the obligations set forth in Article 47, paragraph 3 of this Law, as evidenced by the draft agreements to be concluded in advance with the candidate for independent system operator and other relevant enterprises (if necessary);

e) candidate for independent system operator has proper opportunity to fulfill the obligations related to the transmission system, which means, among other things, cooperation with the transmission system operators at European as well as at regional levels.

According to the Article 45 paragraph 2 of the Law, to ensure independence of the transmission system operator, the same person or persons shall not be entitled at the same time:

a) directly or indirectly to exercise control over an energy undertaking performing any of the activities of production or supply, and directly or indirectly exercise control or exercise any right over a transmission system operator or over a transmission network;

b) directly or indirectly to exercise control over a transmission system operator or over a transmission network, and directly or indirectly exercise control or exercise any right over an energy undertaking performing any of the activities of production or supply;

c) to appoint members of the supervisory board, the management board or bodies legally representing the undertaking, of a transmission system operator or a transmission network, and directly or indirectly exercise control or exercise any right over an energy undertaking performing any of the activities of production or supply; and

d) to be a member of the supervisory board, the management board or bodies representing the undertaking, of both an energy undertaking performing any of the activities of production or supply and a transmission system operator or a transmission network.

The State of Georgia owns 100% of the shares of the Applicant and the rights of the shareholder are exercised by the Ministry. Accordingly, the highest management body of the Applicant is the State, whereas the Minister appoints the General Director. The State owns also 100% of shares of electricity generators – LLC Enguri HPP and LLC Vardnili HPP Cascade. The shareholder rights to LLC Enguri HPP are also exercised by the Ministry. Ministry also exercises management rights to the supplier of natural gas – JSC Georgian Oil and Gas Corporation as well as to the trader of the electricity – JSC Electricity System Commercial Operator.

According to the Article 4, paragraph 2 of “Electricity Transmission System Operator Unbundling Plan”, adopted through the Government Resolution N682, dated November 13, 2020, the Government of Georgia determined a temporary measure, according to which the Ministry shall reallocate management rights to the energy enterprises at least among the structural divisions of the Ministry. In order to meet this obligation, in accordance with the Order of the Minister N1-1/521, the shareholder/partner rights to the mentioned enterprises were divided between the Department of Energy Policy and Investment Projects and the Department of Energy Reforms and International Relations of the Ministry.

According to Article 15, paragraph 4 of the Law of Georgia on the Structure, Powers and Rules of Activities of the Government, the ministries are based on one-person rule, unless otherwise provided by the Laws of Georgia. According to paragraph 5 of the same Article, the authority of the ministry is determined by the Laws of Georgia and/or by the Government resolution. According to the first paragraph of Article 18, the ministries shall be divided into structural divisions in accordance with the statute of the respective ministry; According to paragraph 2 of the same Article, the authority of the structural division of the ministry shall be determined by the statute of the ministry and the statute of this structural division, which shall be approved by the minister; According to paragraph 1 of Article 20, the ministry is headed by a minister who shall take decisions within the competences as determined by the Laws of Georgia.

In accordance with the Article 6, paragraph 2, subparagraph “n” of the Statute of the Ministry of Economy and Sustainable Development of Georgia (hereinafter - the Statute of the Ministry) approved by the Resolution N70 of the Government of Georgia, dated on February 11, 2016, the Minister shall issue orders according to the Laws and other normative acts of Georgia; According to paragraph 6 of the same Article, the Minister is authorized to establish a different rule for the reallocation of functions between the structural divisions defined by the Statute of the Ministry, through the order of the Minister.

Although the Minister did reallocate the management rights of energy enterprises between the structural divisions of the Ministry, in accordance with the Laws of Georgia, the one-person rule principle shall be still considered. This principle implies the sole responsibility of the Minister on decision-making. Order N1-1/521 of the Minister, which established the different rules for reallocation of management rights of energy enterprises, does not establish any special powers of decision-making for the Deputy Minister, structural divisions of the Ministry and/or their heads.

Article 4 paragraph 2 of the “Electricity Transmission System Operator Unbundling Plan”, adopted through the Government Resolution N682, dated November 13, 2020, clearly indicates that reallocation of the rights of management of the energy enterprises among the structural divisions of the Ministry is a temporary measure. Paragraph 3.1.9 of the Unbundling Plan sets out the obligation to ensure the reallocation of management rights to energy enterprises within the Ministry in order to meet the statutory independence and unbundling requirements, which had to be performed by 9 August 2021. However, as mentioned above, the documents and information confirming the implementation of paragraph 3.1.9 of the Unbundling Plan were not submitted to the Commission by the Applicant.

The staff list submitted by the Applicant indicates that the Applicant has the employees of sufficient qualification to perform the functions and obligations provided in Articles 51 and 52 of the Law: metering of the natural gas and monitoring, measuring and controlling instruments and

metrology, operation of transmission of natural gas, odorization, engineering, and technical support, design-costing and cathodic control, indestructible control, main gas pipelines, and gas distribution stations are managed and operated by specialized structural divisions. The Applicant also has an indestructible control testing laboratory and natural gas testing laboratory as well as sufficiently equipped territorial unities. According to the financial opportunities analysis submitted by the Applicant, the Applicant can accumulate sufficient financial resources to perform the obligations as an independent system operator. In particular, part of the revenue of the Applicant is directed to the performance of the functions related to the main activities of the independent system operator, including to ensure construction, operation, maintenance, and development of a safe, reliable, and efficient transmission system by the economic conditions; meet reasonable requirements for the transmission of natural gas within a defined area and the appropriate means to meet its service obligations, to protect both the open market and the long-term capacity of the transmission system. As for physical and technical resources, according to Article 46, paragraph 2, subparagraph "b" of the Law, the Commission is not able to study this issue, as far as lease agreement between the Transmission System Owner and the Applicant has not been submitted. This lease agreement is supposed to be a legal ground for the Applicant to possess, use and operate the transmission system. Without this lease agreement, the Commission is not able to assess, whether the Applicant meets the criteria stated in Article 46, paragraph 2, subparagraphs "c" and "e", in particular, whether the Applicant has the capacity for implementing transmission network 10-year development plan and performing obligations related to it. Also, the transmission system owner does not confirm the ability to meet the requirements provided by Article 46, paragraph 2, subparagraph "d", which include the financing of the investments, insurance of responsibilities, and development of the network. The transmission system owner did not submit draft contracts to fulfill the obligations stated in Article 47, paragraph 3 of the Law, to be concluded with the Applicant and other relevant parties, if necessary. Neither the Transmission System Owner nor the Applicant did not submit to the Commission any documents, data, or information that would confirm the performance of these obligations.

According to the Article 47, paragraph 4 of the Law, independent system operator shall possess assets of transmission system network, on the basis of the consent of the transmission system owner, according to the Laws of Georgia. The Commission approves the lease agreement between the Applicant and the transmission system owner, including the rent for using the assets.

The Applicant and the Transmission System Owner did not conclude the lease agreement, which, according to the information provided by the Applicant, shall be the only legal basis of possession of the transmission network. In case of absence such lease agreement, the Applicant is not able to prove the capacity of fulfillment the obligations provided by the Article 47, paragraph 1, subparagraphs "a" and "b" of the Law, through provision of access to network for the third parties, operation of using this right, including administration of sufficient tariffs and costs, and, in case of authorization of the Applicant as an independent system operator, operation, maintain and develop the

transmission network, ensuring long-term ability to meet reasonable demand by the transmission system, through sufficient investment planning.

For the case of authorization of the independent system operator, Article 31 of the Law establishes additional regulatory authority of the Commission. In particular, Article 31, paragraph 1, subparagraph "b", the Commission shall monitor the relationship between the independent system operator and transmission system owner, including adoption of draft agreements and if the parties apply to the Commission, the Commission shall solve the dispute between the parties.

All of the abovementioned shows that in case of the absence of lease agreement the Applicant is not able to confirm that it meets the requirements of the independence and unbundling, because the legal ground for possession of the transmission system is not on face, accordingly, the Applicant cannot prove the capacity to fulfill the obligations determined by the Law.

Charter of the Transmission System Owner also does contradict independence and unbundling requirements established by the Law. In particular, paragraph 3.8, subparagraph "i" of the Charter states that for the conclusion of any agreement by the transmission system owner, the value of which exceeds GEL 100 000, general meeting of shareholders (JSC Georgian Oil and Gas Corporation) shall provide its consent; However, it is implied that the consent of the general meeting of shareholders is not required to conclude a transaction of any value in accordance with the approved business plan; as for the subparagraph "j" of the same paragraph of the charter, the general meeting of shareholders shall adopt lease agreement to be concluded with the independent system operator, as well as draft amendments to it. According to Article 48, paragraph 1 of the Law, if an independent system operator is authorized, the transmission system owner who is part of the vertically integrated undertaking, must be independent at least in terms of legal form, organizational arrangement, and decision-making from other activities not related to the transmission, distribution or storage of the natural gas. Due to the requirements of independence and unbundling, it is inadmissible to restrict the authority of the natural gas transmission system owner to enter into an agreement without the consent of JSC Georgian Oil and Gas Corporation, which is engaged in the supply and trade of the natural gas. Also, approval of the lease agreement, that shall be concluded by the transmission system owner with the independent system operator, by the supply and trade energy enterprise, or otherwise affect the process of concluding this agreement or its content, shall be assessed as contradictory with the independence and unbundling requirements established by the Law. According to the abovementioned circumstances, the current version of the charter of transmission network owner does not comply with the requirements of independence and unbundling, provided by the Law and the Unbundling Plan.

According to the Article 159, paragraph 6 of the Law, the Commission shall monitor the unbundling process and continue using of the regulatory functions if the requirements of this article are not met completely. Article 159, paragraph 1, subparagraph 6, subparagraph "b" states that the

requirements related to independence and unbundling, shall be met not later than December 31, 2021; according to the paragraph 7 of the same Article, sufficiently unbundled transmission system operator, which applies to the Commission for certification and licensing, shall be certified according to the requirements of Article 50 of the Law. The Commission shall take decision on certification and licensing of the transmission system operator not later than the deadlines set forth in the paragraph 1 of this Article.

According to the Certification Rules and the Law, the Commission shall take preliminary decision on certification of the transmission system operator, submit it to the Energy Community Secretariat and, only after that, take final decision on certification of the transmission system operator; after that the transmission system operator shall be licensed according to the Law of Georgia “on Licenses and Permits” and the Commission shall set natural gas transmission tariff. In such circumstances, the preliminary decision on the certification of the natural gas transmission system operator, shall be made not later than September 2, 2021.

The Commission states that the submitted Application does not meet the requirements of Article 78 of General Administrative Code of Georgia, Article 47, paragraph 4 of the Law and Article 6 of the Certification Rules. By September 2, 2021, the Applicant and the Transmission System Owner have not fulfilled the requirements of the Unbundling Plan. Accordingly, the Commission claims that the Application shall be declined and the Applicant shall be refused to be certified as a transmission system operator.

Taking into consideration all of the abovementioned circumstances, according to the Article 50, paragraph 2 and Article 159, paragraphs 6 and 7 of the Law of Georgian on Energy and Water Supply, Article 52 and 53 of the General Administrative Code of Georgia and Article 9, paragraph 1 of the Transmission System Operator Certification Rules approved by the Commission Resolution №9 of 27 March 2020, the Commission

Decides:

1. The preliminary decision on refusal of Certification Application of the LLC “Georgian Gas Transportation Company” shall be adopted;
2. This Decision enters into force on the day of its announcement at the public hearing of the Commission;
3. This Decision may be appealed at the Tbilisi City Court (Tbilisi, D. Aghmashenebeli Alley, №64), within 1 (one) month of service of the decision.