

## Response to the request for review #2 for “Refurbishment of Enguri Hydro Power Plant, Georgia” CDM project

- A. The DOE is requested to clarify how it validated prior consideration of CDM for units 2 and 4 considering that the PP obtained a loan for the rehabilitation of these units in December 2001, signed a contract with VSH in November 2002, and without any real termination of the contract, project works continued at the site and were completed by August 2009 for both the units.

### I. Introduction

According to the EB62, Annex 13, Para 6a: *“The project participant must **indicate awareness of the CDM prior to the project activity start date, and that the benefits of the CDM were a decisive factor in the decision to proceed with the project.** Evidence to support this would include, inter alia, minutes and/or notes related to the consideration of the decision by the Board of Directors, or equivalent, of the project participant, to undertake the project as a CDM project activity”.*

Prior consideration of CDM and the rationale behind the choice of a start date for the Enguri project is linked to the fact that the Enguri project falls under the EB41, Para 67 (in particular the text in bold): *“there may be circumstances in which an investment decision is taken and the project activity implementation is subsequently ceased. **If such project activities are restarted due to consideration of the benefits of the CDM** the cessation of project implementation must be demonstrated by means of credible evidence such as cancellation of contracts or revocation of government permits”.*

As such, the request for registration of the Enguri CDM project is made **not** on the basis of CDM being considered prior to obtaining initial financing in December 2001 (or the signing of the contract with the contractor in November 2002) **but on** the basis of CDM being considered as a crucial factor to secure additional financing to restart the project (with an extended scope) after work on the ground ceased on 12 December 2005 (project implementation resumed on 13 January 2006 – Note: the start date was changed compared to the previous version of the PDD. Detailed explanations are provided in section 2 of the response).

#### **Note: clarification on the Enguri units and their order in the rehabilitation schedule**

The initial rehabilitation plan envisaged the complete refurbishment of Unit 3 (not part of the CDM project scope) followed by works on Unit 2 and Unit 1. The 2001 EBRD loan ended up covering only the completion of works on Unit 3. Facing financial difficulties, Engurhesi was not able to carry on with the rehabilitation programme. Using CDM as an additional guarantee, Engurhesi managed to secure additional funding to cover the rehabilitation works on Units 2 and 1, and undertake the refurbishment of Unit 4 and 5.

Due to technical reasons, Unit #1 was later replaced by Unit #4 in the schedule via amendment agreement signed with the contractor, Voith Siemens, in 2007. The Amendment states: *“during the execution of rehabilitation works the Employer requested the contractor, due to unforeseen design deviations (turbine head cover) within Employers scope of supply and works, to rehabilitate Unit #4 instead of Unit #1”* (Annex 1).

This substitution of units in the order of rehabilitation is immaterial, as all units (except Unit 3) are covered by the proposed CDM project and:

- the same scope of refurbishment works was planned for each of them,
- the rehabilitation was from the outset planned to be undertaken unit by unit (not simultaneously).

The clarification has been added to the PDD (version 07, dated 31 January 2012, section A.4.3., page 7).

Therefore, please keep the above clarification in mind, when references in following sections are made to Unit 1 (and not Unit 4 as mentioned in the CDM EB’s request for review).

Furthermore, although Unit 3 is not part of the CDM project (as works were fully completed with the EBRD loan and without support of CDM revenues), it is important to discuss its rehabilitation as it greatly impacted the amount of funding available for the rehabilitation of the other units and caused severe delays in the overall rehabilitation schedule.

## **II. Demonstration of CDM prior consideration for Units 2 and 1 (replaced by Unit 4 in 2007):**

The request for review states ***‘without any real termination of the contract, project works continued’***. However, there is no strict requirement in the EB 41 Paragraph 67 to demonstrate that the contract was terminated. The specific wording allows for other pieces of evidence to be provided to demonstrate the cessation of the project:

*The Board further noted that there may be circumstances in which an investment decision is taken and the project activity implementation is subsequently ceased. If such project activities are restarted due to consideration of the benefits of the CDM the cessation of project implementation must be demonstrated by means of credible evidence such as cancellation of contracts or revocation of government permits. Any investment analysis used to demonstrate additionality shall comply with the requirements of paragraph 7 of the “Guidance on the assessment of investment analysis” (version 02).”*

As such, a project activity that ceased but was subsequently restarted needs to demonstrate two things to be eligible for CDM:

1. That the project activity implementation had actually ceased (two example documents are suggested as credible evidence in para 67 above). Other credible evidence is clearly permissible.

2. That the project was restarted due to consideration of the benefits of CDM.

If these two elements are demonstrated, then the 'start date' becomes the date at which project implementation activity was re-started.

**Note:** The previous PDD version assumed a start date of **21 December 2005**, as on that date the project proponent committed to pursuing CDM revenue as a way to restart and complete the implementation of the rehabilitation project, after work on site had fully ceased on 12 December 2005. However, following the requests for review, this date was changed to **13 January 2006**, the date at which the contractor came back to the site and resumed the implementation of the rehabilitation work.

### **1. Cessation of project activity implementation**

As discussed above, it is not a strict requirement to prove that supply contracts are **terminated**. Rather, cancellation of supply contracts is stated as one form of credible evidence that could be used to demonstrate the cessation of project implementation activity. The use of '*such as*' in EB 41 Paragraph 67 clearly demonstrates that contract cancellation is an example of supporting evidence, rather than the only acceptable form of evidence. In the case of the Enguri project, other documents have been used to demonstrate that work ceased due to the events detailed below:

- Following financial difficulties experienced by Engurhesi (the CDM project proponent), Engurhesi failed to meet its payment obligations to the contractors (Voith Siemens and sub-contractors).
- The security situation surrounding the project site deteriorated significantly during this period and the security of the contractors' staff could no longer be guaranteed.

As a result, works ceased on the ground and the contractor's staff left the site on 12 December 2005. The contractor accepted to resume work only after **both issues** had been addressed.

### ***Chronology of events leading to the cessation of the project***

**21 December 2001 - EBRD loan:** the initial loan provided in 2001 by EBRD amounted to USD 14.8 million and was contracted to carry out the following scope of work:

- Complete reconstruction of Unit 3 which was out of operation since 1993;
- General maintenance on Units 2 and 1 (not technical upgrade). For technical reasons as explained above, Unit 1 was later replaced by Unit 4.

**Note:** the scope of work to be conducted under the EBRD loan differs drastically from the CDM project activity. First of all, two more units (Units 4 and 5) are included in the CDM project. More importantly, the CDM scope of work on Units 2 and 1 goes beyond what was planned under the 2001 EBRD loan. Instead of only carrying out general maintenance on the existing equipment of Units 2 and 1, the CDM project activity proposes to fully upgrade the installations, following the example of Unit 3.

**25 November 2002:** Engurhesi Ltd. signed a contract with Voith Siemens (key contractor) to undertake works on Unit 3, Unit 2, and Unit 1. This is the **starting date** of the rehabilitation programme (not the CDM project).

**2003:** the works on the Enguri HPP have been phased in order to minimize disruptions to the plant operations. The works on Unit 3 started in 2003<sup>1</sup>, with the two other units to follow.

**2004-2005 – Financial difficulties:** The rehabilitation of Unit 3 demonstrated that all the other units could be technically upgraded (and not only repaired as originally envisioned), if more investment was provided. Yet, as explained in the PDD (version 07) page 19, the project was already experiencing financial difficulties due to the following reasons (Annex 2):

- i. The US\$ experienced a drastic devaluation of about 30% vis-à-vis the Euro<sup>2</sup>,
- ii. Increased costs were incurred due to delays in the schedule of rehabilitation works,
- iii. Increased costs were further caused by the necessary scope expansion for the rehabilitation works

As a result, by the end of 2005, Engurhesi had completed works on Unit 3 but was unable to start works on Unit 2 (an estimated shortfall of **US\$1.1 million** was recognized for the rehabilitation work on Unit 2<sup>3</sup>), let alone Unit 1 (which was planned to undergo maintenance 13-14 months afterwards). Because of these severe financial difficulties, Engurhesi could not pay the contractors in a timely manner<sup>4</sup>. These difficulties are also demonstrated in the breach of financial terms of the loan agreement with EBRD<sup>5</sup>.

This situation was further aggravated by the assault on a member of staff, and by riots in the region. The VSPO (contractor's) car was attacked on the way back from Zugdidi to Saberio (inside Abkhazia). During that incident the security chief Mr. Shish lost his life and several persons in the car were injured.<sup>6</sup>

Consequently, on **12 December 2005** works on the ground stopped completely, and the contractor's and sub-contractors' staff were demobilized and left the site<sup>7</sup>. After this date, no activity was conducted on site until the financials and security issues were resolved. As such,

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<sup>1</sup> As written on the invoice from Voith Siemens "Effective date, Start of Unit 3 – 20.08.2003",

<sup>2</sup> As shown in the PDD (version 07), page 22-24.

<sup>3</sup> Annex 2: Minutes of Meeting of the Board of Directors of "Engurhesi" Ltd on December 25, 2005, page 4: "1. Due to USD/EUR devaluation since allocation of EBRD loan until end of November 2005, which is over 20%, deficit of financing for Unit#2 already reached 500 thousand USD" and "2. Considering requirement for additional supplies and works on Unit #2, additional funding shall be sought for Unit #2 in the range of 1.1 million USD."

<sup>4</sup> Annex 3: Extracts from documents proving that Engurhesi failed to pay contractors, and that works on Unit 2 kept being postponed.

<sup>5</sup> As proved by the Quarterly Reports 2004 and 2005, mentioned in the PDD (version 07) page 28-30. Also, please refer to the Letter from the EBRD attached to this response.

<sup>6</sup> Annex 4: Status Protocol. CW 47-29 dated 21.12.2005

<sup>7</sup> Ошибка! Источник ссылки не найден.

this date – backed up by the letter from the contractor<sup>8</sup> – is treated as **the cessation date** of rehabilitation works (as required by EB41, Para 67).

This provides conclusive evidence that project implementation activity **ceased** on the ground before the project was restarted as a CDM project.

**In summary:** The 2001 Loan Agreement with EBRD was assumed to cover works on Unit 3<sup>9</sup>, Unit 2 and Unit 1. In 2002, Engureshi entered into a contract with Voith Siemens to carry out the works. Most payments under this contract were to be made in Euros while the EBRD loan was in US Dollars. Because of the Dollar devaluation against the Euro between the date of loan signing and the payment of contractor invoices, the loan turned out to be only sufficient to complete works on Unit 3 and initiate works at Unit 2<sup>10</sup>. As a result of these financial issues and security issues, the work on site stopped completely and the contractor staff were demobilised, before any work on Unit 2 (or subsequent Units 1, 4 and 5) started.

## 2. Consideration of CDM benefits to restart the work

As demonstrated above, the reasons for cessation after rehabilitation of the first unit (Unit 3) were two-fold: (i) the non-payment of contractor's invoices and security issues. Once the contractor left the site on 12 December 2005, they refused to resume work unless and until the security and the financial issues had been addressed<sup>11</sup>. CDM was considered at that time to help address the financial issues and help secure additional funding to start work on the other units.

### *Chronology of events*

On **20 December 2005**, the project company drew from the remaining funds under the 2001 EBRD loan to cover the outstanding payments to complete Unit 3 and to initiate works at Unit 2. Yet, this amount was not enough to complete Unit 2, and undertake refurbishment works on remaining units.

On **21 December 2005**, as evidenced by the minutes of the Board Meeting, financial problems of the project were discussed and it was agreed that "*additional funding must be requested to complete the rehabilitation program*". The Project Implementation Unit (PIU) Director of Engurhesi put forward the idea of carbon credit revenues as a way of overcoming the financial

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<sup>8</sup> Annex 5: Voith Siemens Letter on work stop and restart

<sup>9</sup> Unit 3 is not part of the CDM project scope, as its rehabilitation has been fully financed under the 2001 EBRD Loan Agreement.

<sup>10</sup> As shown in the EBRD Loan Drawdown Notice as of 31 December 2005 (Annex 6), only USD 5.95 million were remaining as of the end of 2005 while actual cost of Unit 2 based on Voith-Siemens invoices and payments (Annex 7) totaled USD 7.35 million (exchange rate used as per Annex 6 at the end of 2005: 1 USD=0.832 EUR) . As such, Engurhesi was short of USD 1.4 million to complete Unit 2, let alone Unit 1.

<sup>11</sup> Annex 4: Site-Meeting Protocol. CW46 dated 27.09.2005; Annex 5 Voith Siemens Letter on work stop and start

problems. At the Board Meeting, the project company committed to starting negotiations with EBRD for additional funding, with the explicitly stated intention of seeking project registration under the CDM (*“the Project Manager of PIU to initiate discussions with EBRD for registration of the Enguri HPP rehabilitation project in the UNFCCC with the view of obtaining additional source of funding through potential Carbon Credits generated by the Rehabilitation Project”*).<sup>12</sup>

Therefore, at the Board Meeting, CDM revenues were identified as a way to *“support mitigation of financing deficit for Unit 2 and for remaining units”*<sup>13</sup> i.e. to cover the financing gap left by the currency devaluation and to co-finance (together with prospect of EBRD additional funding) rehabilitation of Unit 1, Unit 4, and Unit 5.

In this context, Engurhesi started negotiations with the EBRD to seek additional funding. In the meantime (on **22 December 2005**), the company applied to a domestic bank, ProCredit Bank, for an emergency loan, to cover the immediate financing gap ((i) ongoing operation costs and (ii) ongoing rehabilitation works)<sup>14</sup>. Yet, as explained in the response to request for review #3, the domestic loan was merely intended to bridge the period until the Second Novation Agreement.

Once Engurhesi started securing the necessary funding (as mentioned in the Board Meeting of 21 December 2005) and implementing security measures (Annex 5), the rehabilitation works on Unit 2 could start.

On **13 January 2006**, Voith Siemens staff returned to the project site and restarted works.

**Note:** This date is taken as the CDM start date in compliance with EB 41, Paragraph 67, since the project activity restarted after the firm commitment of the project proponent to seek CDM finance.

After months of negotiations with EBRD, the Second Novation Agreement was signed **in 2006** for an additional USD 10 million. Its purpose was to finance the deficit for completion of refurbishment works on Units 2 and 1, and for undertaking the refurbishment works on the other units, with an explicit requirement to seek CDM financing to serve as a key source of revenues to meet the loan repayment obligations.

**As evidence:** Schedule 2 to the Second Novation Loan Agreement on Enguri Hydro Power Plant Rehabilitation project of **29 December 2006** – “Categories and Drawdowns” – sets forth the categories of items to be financed out of the proceeds of the loan, the allocation of the loan to each category, and the maximum percentage of expenditures for items to be financed in each category. Amongst 14 categories, the following two are listed:

*(3) Electrical and Mechanical Works for Units 1, 2 and 3*

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<sup>12</sup> **Ошибка! Источник ссылки не найден.** dated 21 December 2005

<sup>13</sup> **Ошибка! Источник ссылки не найден.** dated 21 December 2005

<sup>14</sup> Letter to ProCredit Bank of 22 Dec 2005, explaining reasons for seeking additional funds, Document #22 mentioned in the PDD, page 35

(10) *Electrical and Mechanical Works for Unit 4 and/or 5, additional civil engineering works (...).*

**Note:** “and/or” was written because a lot of uncertainties remained at the time, in particular regarding: a) which of the last two units would be refurbished first, b) to what extent the additional EBRD funds would cover the required works, c) what would the total amount of funding available be, given the fact that a maximum of USD 10 million was available as an additional loan after negotiations with EBRD and that CDM revenues were planned to co-finance the rest.

The CDM component has been essential to secure additional investments in the Enguri HPP rehabilitation. Paragraph (e) in Section 3.01 (“Other Alternative Project Covenants”) of the Second Novation Loan Agreement on Enguri Hydro Power Plant Rehabilitation project of 29 December 2006 states: *“undertake and/or procure that all necessary steps are taken to enable the Project to qualify for the Clean Development Mechanism and ensure that the funds raised through the CDM are used in priority for meeting the Borrower’s and the Novation Project Company’s obligations regarding the Project”*.

In other words, despite the constant breach of financial covenants (as proved by the Quarterly Reports)<sup>15</sup>, EBRD accepted to lend additional funds to Engurhesi on the basis that CER revenues will be used to repay the loan.

Moreover, even prior to the ‘Novation Loan Agreement’ coming into force in December 2006, EBRD appointed ICF Consulting Ltd as CDM consultant for this project (contract signed on 12 September 2006), demonstrating the intention to proceed using carbon finance.

**In summary:** From 21 December 2005 onwards, steps were undertaken to secure funding for completion of the entire rehabilitation programme that is covered by the proposed CDM project scope, i.e. Unit 2, Unit 1, Unit 4, and Unit 5. Before this date, no works had started on any of these units.

With the explicitly stated intention of seeking CDM revenues, Engurhesi started negotiations with EBRD to receive additional funding. Yet, given the fact that such negotiations require time, the project company drew from the remaining amount under the 2001 EBRD Loan to settle outstanding payments and applied for an emergency loan to a domestic bank. Both actions were taken to avoid further delays in the project implementation.

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<sup>15</sup> Q1 2004 - 18th Quarterly Project Report; Q2 2004 - 19<sup>th</sup> Quarterly Project Report; and Q3 2004 - 20<sup>th</sup> Quarterly Project Report; Q1 2005 - 22<sup>nd</sup> Quarterly Project Report; Q2 2005 - 23<sup>rd</sup> Quarterly Project Report; Q3 2005 - 24<sup>th</sup> Quarterly Project Report – as mentioned in the PDD page 25. For example: Q3 2005 - 24<sup>th</sup> Quarterly Project Report, page 17 – 18, an exemplary covenant in breach include: *“Selected End-users and the distribution company to pay into the Revenue Collection Account to be used in priority for the payments into the Debt Service Account for loan servicing until minimum of 6 months debt service is covered, before the revenues are re-allocated. Covenant is in breach: Although the unified Revenue Collection Account has been set up for transfers from the Distribution Market (GWEM), Engurhesi Ltd (Project Company), as well as the GSE (Borrower), due to low collection of revenues by GWEM which is the sole consumer of power produced by Enguri HPP, are unable to either accumulate or repay the loan principle and interest as set forth in NLA Section 2.02 (d).* The EBRD letter included in the package of key supporting documents confirms that the project proponent was in default of its loan with EBRD.

Finally, since 2001, EBRD has indeed been a key source of funding for Engurhesi. However, the Second Novation Loan signed in 2006 (after long negotiations which started shortly after Engurhesi's board decision at the end of 2005) was granted with the requirement that Engurhesi would seek CDM benefits in order to meet its loan repayment obligations.

Considering that steps were undertaken to secure funding for completion of the entire rehabilitation programme covered by the proposed CDM project scope, and that security measures were implemented, the contractor came back to the site on **13 January 2006** and resumed rehabilitation works. As such, this date is considered to be **the start date** of the proposed CDM project, as required by the EB 41, Paragraph 67.

In other words, once the additional funding was secured via Second Novation Loan – which mentions all units covered by the proposed CDM project<sup>16</sup> – it was possible to move on with the rehabilitation project, complete Unit 2 and start subsequent units in the schedule (i.e. Unit 1, Unit 4 – later swapped with Unit 1, and Unit 5).

As such, the refurbishment works covered by the proposed CDM project started after the project start date (13 January 2006), and after considering CDM revenues as a decisive factor to continue with the project. The detailed rehabilitation schedule is outlined in the PDD, Section A.4.3.

**B. The DOE is requested to clarify how it validated prior consideration of CDM for unit 5 considering that the Board resolution dated 21/12/2005 does not include CDM consideration to proceed with rehabilitation of unit 5, but only units 1 and 2 (PDD page 30).**

**Please refer to VVM paragraph 104 (b).**

First of all, it is important to note that the project “Refurbishment of Enguri Hydro Power Plant, Georgia” is a staged project, which means that all units are rehabilitated one by one (but never simultaneously). This is a key reason for applying for and obtaining funding for the various units in different stages as rehabilitation progresses. This approach has also been necessary to ensure the appropriate management of funding and ensure enough funds were available for each unit, given the financial and implementation issues experienced with Unit 3. The contract with Voith Siemens (key contractor) assumes that rehabilitation works on a subsequent unit only start upon the completion of works on a previous unit.

As already mentioned above, while rehabilitating Unit 3, it was demonstrated that all the other units could be technically upgraded (and not only repaired as originally envisioned), if more investment was provided. Yet, by the end of 2005, the project company was facing financial

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<sup>16</sup> Schedule 2 to the Second Novation Loan Agreement on Enguri Hydro Power Plant Rehabilitation project of 29 December 2006 – “Categories and Drawdowns”



problems and the loan turned out to be only sufficient to complete rehabilitation of Unit 3, and initiate works on Unit 2.

However, the Board resolution does in fact mention “Unit #2 and remaining units”. As such, while the Board resolution indicates financial details for Unit 2, attention should be paid to the fact that the Board mentions CDM for the whole project and not only for specific units.

In all, the Minutes of the Board Meeting provide the proof that the project proponent was committed to refurbishing not only Units 2 and 1 (which was later replaced by Unit 4 in the schedule due to technical reasons), but also the remaining units and that additional funding was being sought for the entire project.

Also, as mentioned above, the Second Novation Agreement of 2006 mentions all units covered by the CDM project scope, including Unit 5.<sup>17</sup>

Furthermore, Unit 5 was planned to be refurbished as the last one, as it is in the best operating condition out of all units covered by the CDM project (provided funding is secured, and refurbishment works on previous units are completed).

Please note that relevant information was included to the Validation Report rev.05 section 3.7.1. p.16-20.

Please note that necessary revisions to reflect in a clearer way the above arguments have been made to the PDD, version 07 dated 31 January 2012 (mainly in Section B.4 and B.5).

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<sup>17</sup> Please note that the Second Novation Agreement of 2006 mentions all units covered by the CDM project scope. Schedule 2 to the Second Novation Loan Agreement on Enguri Hydro Power Plant Rehabilitation project of 29 December 2006 – “Categories and Drawdowns” – sets forth the categories of items to be financed out of the proceeds of the loan, the allocation of the loan to each category, and the maximum percentage of expenditures for items to be financed in each category. Amongst 14 categories, the following two are listed:

*(3) Electrical and Mechanical Works for Units 1, 2 and 3*

*(10) Electrical and Mechanical Works for Unit 4 and/or 5, additional civil engineering works (...).*

# Appendices

## **Annex 1: Amendment No.6 to the Contract Agreement for the Electro-Mechanical Equipment of the Enguri HPP, page 1**

ENGURI REHABILITATION PROJECT  
Amendment No. 6, Rev 01  
Date: 2007-04-17

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### **AMENDMENT No.6 TO THE CONTRACT AGREEMENT FOR THE ELECTRO-MECHANICAL EQUIPMENT OF THE ENGURI HPP**

**BETWEEN**

**ENGURHESI LTD.  
AND  
VOITH SIEMENS HYDRO KRAFTWERKSTECHNIK GMBH & CO KG**

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**REFERENCE:  
CHANGE OF UNITS, UNIT#4 TO BE REHABILITATED INSTEAD OF UNIT#1**

#### **(I) AIM OF THE AMENDMENT**

According to the contract agreement between Enghuresi Ltd. and Voith Siemens Hydro Kraftwerkstechnik GmbH & Co. KG, dated November 25<sup>th</sup>, 2002, the scope of supply and works is contracted for the rehabilitation of:

- the auxiliary systems
- unit #3 (1<sup>st</sup> Unit to be rehabilitated)
- unit #2 (2<sup>nd</sup> Unit to be rehabilitated)
- unit #1 (3<sup>rd</sup> Unit to be rehabilitated)

During the execution of the rehabilitation works the Employer requested the Contractor, due to unforeseen design deviations (turbine head cover) within Employers scope of supply & works, to rehabilitate unit #4 instead of unit #1.

According to the statement of the Employer the unit change is essential to keep the time schedule according to the initial contract and revised as stated in amendment 2 dated may 31<sup>st</sup>, 2005.

**Annex 2: Minutes of Meeting of the Board of Directors of “Engurhesi” Ltd on December 25, 2005, page 4**

Presented By:

- M. Tskvitishvili Narrative of Manager of the Project Implementation Unit on available funds for Unit #2 rehabilitation and on sources of funding:
1. Due to USD/EUR devaluation since allocation of EBRD loan until end November 2005, which is over 20%, deficit of financing for Unit #2 already reached 500 thousand USD.
  2. Considering requirement for Additional supplies and works on Unit #2, additional funding shall be sought for Unit #2 in the range of 1.1 million USD.
  3. The donor society shall be informed about the existing funding deficit and additional funding must be requested to complete the rehabilitation program.
  4. Considering the additional output potential from the rehabilitated units, the Ministry of Energy of Georgia shall be solicited to request registration of the Enguri project in the UNFCCC under the Kyoto protocol. Potential additional sources of revenues through Carbon Credits will support mitigation of financing deficit for Unit #2 and for remaining units.
2. The Project Manager of PIU to initiate discussions with the EBRD for registration of the Enguri HPP rehabilitation project in the UNFCCC with the view of obtaining additional source of funding through potential Carbon Credits generated by the Rehabilitation Project.

**Annex 3: Extracts from documents proving that Engurhesi failed to pay contractors, and that works on Unit #2 kept being postponed**

**Site-Meeting Protocol. CW46 dated 27.09.2005**

1.2.	<p><b>Suspension of Contractor's Activities</b></p> <p>On 22 September workers of local sub-contractor of Siemens for assembly works ("Sakenergoremonti Ltd.") stopped working due to non-payment of outstanding salaries for July-August.</p> <p>Employer should provide timely transfer to stop further delays of works.</p> <p>Delays of works due to suspension of activities will be charged to the employer as compensation event.</p>	Employer
1.3.	Employer staff/Contractor	

## Notification of Suspension due to late Payments from the Employer

### Notification of Suspension due to late Payments from the Employer

Dear Sirs,

This is to notify you, that payment for deliveries of equipment and material for Unit 3 has been delayed by the Employer over the time of 45 days as agreed in the contract, thus the Employer has failed to perform his obligations under the clause 41.2 of the contract when not paying the invoices on time.

In this respect please be informed that if the outstanding payment will not be covered by the Employer within the following 28 days, we reserve right to suspend execution of the contract according to GC 42.3 of the contract.

## Site-Meeting Protocol. CW46 dated 19.11.2005

### Notice on Suspension of Planned Start of Unit 2

Works again suspended from 3.11.05 due to repeated delay of payments to sub-contractor of Siemens.

According to updated schedule of works Unit #3 can not be completed until end of December 2005.

#### **Statement of Contractor:**

Unless financial problems are satisfactorily resolved by Engurhesi the Contractor gives a preliminary notice of suspension of works for the start of rehabilitation of Unit #2, which was planned to start on 22.12.05.

#### **Statement of Employer:**

Mobilization of additional resources is in progress which will facilitate works on Unit #2, therefore further delays due to non-payment of contractors will be mitigated.

Recorded delays of works by 24 calendar days for non-payment of salaries (strike of "Sakenergomonti" Ltd. workers in September and in November) will be reviewed by the Employer as a compensation event to Voith-Siemens.

### Preparation for Rehabilitation Unit #2

#### **Rehabilitation Start**

Employer announced Stop and Dismantling start of Unit #2 on 14 December 2005. Contractor cannot accept this date due to delays as mentioned in item 1.1. above.

New start date for Unit 2 shall be agreed in beginning of 2006 after arrangement of financial back-up for the continuation of rehabilitation works.

## Preliminary Notice on Termination of Contract, dated 07.12.2005

### Preliminary Notice on Termination of Contract due to non-payment by the Employer

Dear Sirs,

We have notified you with our letter dated November 1, 2005, that the Employer has failed to perform his obligation to make due payments for deliveries of equipment and material for Unit 3 in the allowed time of 45 days after receiving the invoice.

In addition, the Employer has failed to remedy the existing situation within 28 days after receiving Notice of Suspension from the contractor as indicated above.

The present letter serves as a preliminary Notice of Termination for non-payment by the Employer according to GC 42.3.1 of the contract.

#### Annex 4: Status Protocol. CW 47-29 dated 21.12.2005

20.10.	<p><b>Assault on VSPO Car</b></p> <p>On 11.12.05 the VSPO car was attacked on the way back from Zugdidi to Saberio (inside Abkhazian). During that incident the security chief Mr. Shish lost his live and several persons in the car were injured.</p> <p>Due to that assault and the insecure situation at site all VS /Siemens /VSPO personal left Enguri site to Tbilisi on 12.12.05 and back to Germany on 14.12.05</p> <p>Clarification about return to side is under progress between Contractor and Employer headquarters and security departments.</p>	
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#### Annex 5: Letter from Voith Siemens

**VOITH**

Voith Hydro GmbH & Co. KG, K2, P3, Box 2010, 85622 Mettlheim, Germany

Engurhesi Ltd.  
The Director of the Enguri HPP Rehabilitation  
Project Implementation Unit  
  
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A Voith and Siemens Company

To: Director  
Mr. Joseph  
Dear: Jürgen  
  
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Tbilisi, Georgia -7090  
Date: 2010-12-06  
E-Mail: Joseph.M. Umrsh@voith.com

#### To Whom It May Concern:

1. The rehabilitation works at the Enguri Hydro Power Plant were stopped on several occasions in the year 2005-2006 due to financial difficulty faced by the employer (leading to late payments) and security issues.
2. The rehabilitation works was stopped on several occasions in the year 2005 but on the following dates the work was fully stopped and all expatriate staff of Voith-Siemens, Siemens and its sub-contractors were demobilized from the construction site:  
  
13 December 2005 – 12 January 2006.
3. The rehabilitation works at the site were re-started after both the over-due payments were made by the Employer to and the security issues were addressed.
4. The rehabilitation work was re-started on 13 January 2006 when engineers from Voith-Siemens arrived at site and sub-contractor's personnel were mobilized back to work.
5. Information provided in this letter is accurate and based on historical records.

Yours faithfully  
VOITH Hydro GmbH & Co. KG  
J. Umrsh  
Commercial Project Manager

  
M. Thomczyk  
Project Manager

**Annex 6: EBRD Loan Drawdown Notice as of 31 December 2005**

Annex 3-2: Drawdown of Funds from EBRD Loan (in USD)							
As of 31 December 2005							
				Date	Value		
A Payment from EBRD							
C Payment for Package 2, Electro-Mechanical Works, Voith-Siemens Hydro				Total EBRD Budget, USD			
		Invoice No.	Payment Value Date	Drawdown			
			EBRD	Application	14 810 000,00	EUR	Ex. Rate
1	Advance payment	652 709	19 май 2003	027	1 334 353,47		
2	Advance payment	652 709	19 май 2003	028	3 152 255,29	2 745 388,7 €	0,87
3	Payment for Shipment N051- FOB	653 081	13 апр 2004	034	546 993,95	452 248,0 €	0,83
4	Payment for Shipment N051- CIF	653 096	13 апр 2004	037	22 791,82	18 844,0 €	0,83
5	Payment for Shipment NN001, 054- CIF, N057- FOB	653-090/091/1:	02 июн 2004	039	611 452,88	499 023,0 €	0,816
6	Payment for Shipment N055- FOB	653-125	10 июн 2004	041	580 787,09	470 883,0 €	0,811
7	Payment for Shipment NN002, 052, 056, 065, 064, 066- CIF	653-226/227/21	28 сен 2004	044	969 632,86	787 743,0 €	0,812
8	Payment for Shipment NN055, 059, 4341-3- CIF, LM2, Progress	653-261/262/21	28 сен 2004	045	353 635,11	287 298,0 €	0,812
9	Payment for Shipment N055, 057, 070- CIF	653-126/128/21	28 сен 2004	046	76 351,50	62 029,0 €	0,812
10	Payment for Shipment N4341-29, 072, 076, 077- CIF	653-276/277	16 ноя 2004	050	42 705,00		
11	Payment for Shipment N4341-39, (082)- CIF	653-297/298	16 ноя 2004	051	68 399,46	52 908,0 €	0,774
12	Payment for Three Design Liaison Meetings (I+II+60% of III)	653-333	17 дек 2004	054	132 422,67	98 978,0 €	0,747
13	Progress Payment for Unit 3 and Auxiliaries Rehabilitation	653-364	24 фев 2005	059	363 659,17	274 937,0 €	0,756
14	Completion of Auxiliaries	653-391/392/31	25 май 2005	064	168 047,46	133 413,4 €	0,794
15	Payment for Shipment N009, FOB+CIF	653-482	26 авг 2005	071	146 503,51	119 947,2 €	0,819
16	Payment for completion of Deliveries on Unit3 and Auxiliaries	653-593	20 дек 2005	080	292 540,69	103 348,6 €	\$168 264,0 0,832
Disbursed					8 862 531,92		
Undisbursed					5 947 468,08		

## Annex 7: Actual invoice from Voith Siemens for works on Unit 2

Enguri HPP

Invoices and Payments, VOITH-SIEMENS

UNIT #2			
Invoice No.	Payment	EUR	USD
Advance Payment	19.05.2003	1 191 828,0	411 234,8
Advance portion of Enguri	23.03.2004	294 664,5	78 032,4
653-123	02.08.2004	640,0	
653-091	02.08.2004	15 358,0	
653-125	10.08.2004	69 137,0	
653-126	28.09.2004	2 881,0	
653-482	26.08.2005	119 947,2	
653-752	11.08.2006	1 481 731,0	802 192,0
653-765	11.08.2006	10 800,0	
653-753	11.08.2006	92 659,0	
653-754	11.08.2006	5 880,0	
653-761	11.08.2006	4 145,5	1 105,0
654-040	13.08.2007	54 566,4	
654-046	07.09.2007	28 336,9	
654-065	14.09.2007	1 034,0	
654-057	14.09.2007	12 206,6	
654-058	14.09.2007	23 209,8	
654-059	14.09.2007	13 847,5	
654-060	14.09.2007	1 432,1	
654-061	14.09.2007	7 668,5	
654-062	14.09.2007	54 550,6	
653-927	29.05.2007	4 530,0	
653-936	29.05.2007	23 246,6	
653-855	29.05.2007	17 412,0	
653-935	29.05.2007	8 744,0	
653-933	29.05.2007	22 200,0	
653-755	29.05.2007	14 602,5	
653-852	29.05.2007	44 380,7	
653-878	29.05.2007	332 969,8	
653-972	29.05.2007	142 697,9	
653-974	29.05.2007	2 952,2	
653-920	29.05.2007	24 251,9	
653-918	29.05.2007	17 251,3	
654-108	28.01.2008	220 558,4	79 323,8
654-107	28.01.2008	125 710,7	
654-187	25.02.2008	51 588,8	
654-186	25.02.2008	26 788,7	1 029,4
654-182	25.02.2008		10 333,9
654-242	12.05.2008	207 831,4	
654-243	12.05.2008		72 146,5
654-315	31.07.2008	3 034,5	
654-314	31.07.2008	8 704,0	
654-313	31.07.2008		4 317,2
654-298	31.07.2008	15 228,7	
654-302	31.07.2008	3 570,6	
654-304	31.07.2008	2 080,6	
654-244	15.09.2008	16 704,6	
654-351	15.09.2008	29 246,4	
654-355	15.09.2008	5 249,6	
654-356	15.09.2008	5 572,5	
654-353	15.09.2008	18 713,6	
654-352	15.09.2008	12 582,5	
654-354	15.09.2008	9 186,8	
		€ 4 904 092,40	\$ 1 459 714,91