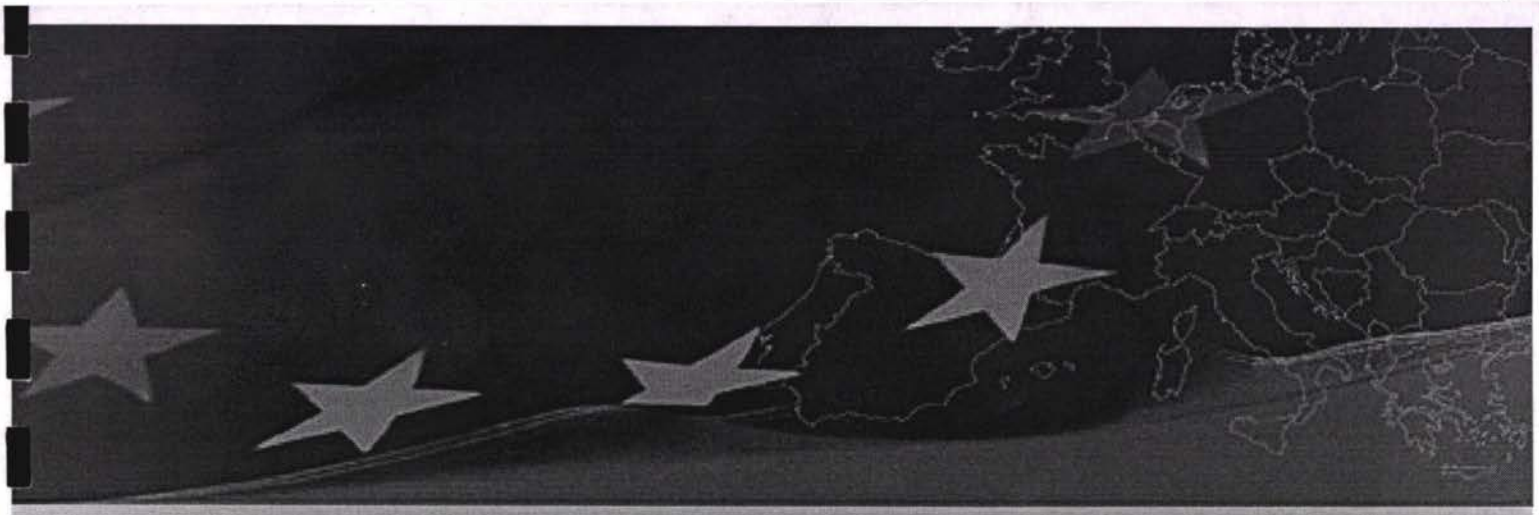

The European Union's Tacis - TRACECA Programme
for Azerbaijan and Georgia

Railway Transit Oil Logistical Centre

for Azerbaijan and Georgia

Module B:
Special Report on Supsa Port Administration
July 2003

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Table of Contents

Abbreviations and Acronyms

ACG	Azeri, Chiraq, Gunashli oil field
AIOC	Azerbaijan International Oil Consortium
BOT	Batumi Oil Terminal
BP	British Petrol Company
BTC	Baku-Tbilisi-Ceyhan pipeline
EC	European Commission
EU	European Union
GIOC	Georgian International Oil Company
GMA	Georgian Maritime Administration
GPC	Georgian Pipeline Company
GT	Gross Tonnage
HGA	Host Government Agreement
LNG	Liquefied Natural Gas
LPG	Liquefied Petrol Gas
mn	Million
MoTC	Ministry of Transport and Communication
NM	Nautical Miles
PCOA	Pipeline Construction and Operation Agreement
SPA	Supsa Port Administration
SPM	Single Point Mooring
t	metric tonnes
Tacis	The European Union's Tacis Programme
tdw	tonnes dead weight
TRACECA	Transport Corridor Europe-Caucasus-Asia

1 Project Synopsis of Module B: Assistance to Supsa Port Administration

Project Title:	Railway Transit Oil Logistical Centre
Project Number:	EUROPEAID/113200/C/SV/Multi
Countries:	Azerbaijan, Georgia

Project objectives

Specific objectives of Module B are:

a. to establish an efficient management structure for the Supsa Port Administration;
b. to outline how to render services to tankers according to international standards;
c. to identify under which conditions Supsa Sea Port Administration can reach self-sufficiency.

Project outputs

Expected outputs of Module B are

1. Supsa Port is able to establish an efficient management structure.
2. Supsa Port is able to render services according to international standards
3. An oil terminal and tanker safety manual has been prepared and is implemented
4. Navigational and vessel safety in the port and its approaches is assured
5. Pollution prevention and pollution combating measures are in place, an oil pollution contingency plan has been prepared.
6. Supsa Sea Port Administration knows in which cases they would be allowed to levy charges on vessels calling at Supsa port.

Project activities

Module B

1. Study the institutional structural design issues of Supsa Port, prepare a critical review
2. Prepare recommendations for an efficient management structure
3. Prepare an oil tankers and terminal operations safety manual
4. Study communication and navigation equipment available in the port and make recommendations
5. Study the logistical equipment issues for Supsa Port and make recommendations
6. Advise on the issues of navigational safety
7. Advise on the issues of environmental protection and prepare recommendations for an efficient and effective environmental protection system and for pollution control and combating equipment
8. Provide pre-project studies for berth construction for the port's auxiliary fleet
9. Specify training requirements in management, safety operations, safety and environmental protection

10. Assist the port administration in implementing the new administrational set-up.
11. Review the Host Government Agreement and the Pipeline Construction and Operation Agreement
12. Investigate whether there exist similar cases in other parts of the world
13. Investigate in how far in other parts of the world vessels and vessel owners calling at Single Point Mooring facilities are charged with vessel and port dues
14. Elaborate on international practice
15. Elaborate in how far international practice and specific examples can be transferred to the Supsa case
16. Elaborate in how far the existing Georgian port regulations support the SPA's funding approach.

Target groups	Oil operators, Supsa Port Administration
Project starting date	6 December 2002
Project duration	12 months

2 Introduction

Module B of the present project has been specifically requested by the Georgian Government in order to strengthen institution building and port planning capacities of Supsa Port Administration. Moreover, it was requested to assist the port in the development and implementation of safety as well as cargo and vessel handling procedures.

However, by the time the project was designed and submitted for approval the impact of a current dispute between Supsa Port Administration (hereafter: SPA) and the sole terminal operator (hereafter: GPC) in Supsa Port were not obvious. As this dispute significantly affects the capacity of SPA to raise income necessary not only for securing day-to-day operations but also for future investment, the Georgian Government requested to include in Module B an investigation on the main funding sources of SPA. The European Commission followed this request and ordered the consultants to independently investigate, in how far SPA may have or have not the right to levy port dues on vessels calling at Supsa port, specifically

- Elaborate on international practice of levying port and vessel dues and respective basic foundations.
- Investigate whether there exist similar cases (SPM without additional port structures) in other parts of the world.
- Investigate in how far in other parts of the world vessel and vessel owners calling at SPMs are charged with vessel and port dues.
- Elaborate in how far international practice and specific examples can be transferred to the Supsa case.
- Elaborate in how far the SPA's funding approach is in line with the existing Georgian port regulations.
- Review of the Host Government Agreement (HGA) and the Pipeline Construction and Operating Agreement (PCOA) with respect to levying charges on vessels.

The following investigation has been subdivided into two parts. After a brief introduction into the current situation of Supsa port and SPA, the consultants have first undertaken to analyse the situation from a mere "technical" point of view. Here, "technical" is indicated to refer to aspects related to international practice in the ports and shipping sector. The second part focuses on an appraisal of the two main legal documents on which terminal operations in Supsa are based.

The following analysis is based on interviews with the representative of SPA and GPC Terminal Operations Management as well as an on-site visit to Supsa. Moreover, information has been sought from publicly available sources. Last but not least, the consultants have drawn information from the HGA and PCOA (presumably latest official versions), and legal opinions that have been elaborated by legal consultants on behalf of SPA and GPC.

It should be re-stated that the consultants are primarily transport consultants and thus have primarily focused their investigations on the technical aspects of the problem between SPA and GPC. The results and views of the consultants should be interpreted as an independent expert appraisal of the current situation. It can by no means replace a formal legal opinion on his matter from an international law firm specialised in oil and pipeline transportation. All views and opinions expressed are entirely those of the consultants and can in no way be taken to reflect the views of the European Union or the TRACECA Intergovernmental Commission.

3 Situation at Supsa Port

The Georgian port of Supsa constitutes the final point of the Baku-Supsa pipeline through which today about 8 mn tons of crude oil from the ACG (Azeri, Chirag and Gunashli) oil field can be transported annually (for 2003 a throughput of 6.5 mn tonnes is projected). The crude oil comes by pipeline from Baku (Sangachal BP Terminal) and is stored at a tank farm close to the village of Supsa. The tank farm is connected to an SPM (single point mooring) facility about 2 NM off the shore, which can load tankers of up to 150,000 tdw. Upon arrival of a vessel, the vessel is moored to the SPM and connected to a flexible loading arm which itself connects to an underwater pipeline leading to the tank farm. The shore-based part of the connection is buried underground while the sea-based part is reportedly laid on the seabed. In 2002, about 50-60 vessels were loaded.

All vessel and cargo operations are organised and surveyed by a Marine Base situated on the shore directly east of the SPM. The Marine Base is the point of contact for arriving tank vessels and equipped with radar and VHF facilities. It also stores fire fighting and oil spill equipment as well as speedboats. Like the tank farm and the SPM, the Marine Base is operated by GPC Georgian Pipeline Company, a private but non-profit operating company registered in Georgia and owned by AIOC Azerbaijan International Operating Company, which herself is registered on Cayman Islands. AIOC is a consortium of oil companies involved in the exploitation of ACG oil wells in the Azeri part of the Caspian Sea. In front of the Marine Base the Georgian Coast Guard monitors the waters around the SPM. No unauthorised vessel is allowed to enter the area between the Marine Base and the SPM as well as about five hundred meters to the north and south.

All piloting- and loading activities are operated by GPC. GPC also provides fire fighting and oil spill services in case of need. The existing team can do Tier-1 (for fighting small oil spills). On demand the company can provide a Tier-2 team (for fighting medium oil spills). The operation and safety equipment seemingly is in very good condition and according to international standards. Tug assistance on mooring operations is provided by the international maritime operator Smit Ltd. on behalf of GPC. In fact GPC has taken over major part of the tasks of a port authority.

All tanker operators calling at the SPM pay to GPC for the provision of their (and Smit's) services. The tariffs were not revealed to the consultants but reportedly are broadly in line with international levels (taking into account that GPC is a non-profit company). However, it is not reported whether GPC also charge dues related governmental infrastructure or general port services (such as tonnage dues, environmental dues, safety and security dues) on vessel operators.

Operations of the Baku-Supsa pipeline and all related facilities (such as the tank farm, the marine base and the SPM) are legally based on the so-called Pipeline Construction and Operating Agreement (PCOA) and the Host Government Agreement (HGA) concluded in 1996 between the Georgian Government represented by GIOC (Georgia International Oil Corporation) and AOIC. These agreements have the status of a Georgian law.

Supsa Port Administration (SPA) has been established by the Ministry of State Property based on a Presidential Decree in 1999 as a limited liability company and provided with an initial loan from the Georgian Maritime Administration. However, it was made clear that after the initial phase Supsa Port Administration was to be self-sufficient and repay the loan, meaning it should be funded from income generated from port activities of whatever kind. The initial loan has been used up already. All further activities of SPA are now depending on the development of financial sources, as no alimentation from the state budget can be expected.

Moreover, the Georgian Maritime Administration (GMA) under the Georgian Ministry of Transport and Communication appointed a Harbour Master, who acts independently of SPA in line with the Regulations for Har-

bour Master (Order of the Ministry of Transport and Communication no. 10.28.01.99) and port state control procedures (IMO Resolution A.787 (19)). The Harbour Master is exclusively funded by GMA.

Until today, the tasks, responsibilities and strategies of SPA have not been clearly defined. Moreover, the port administration has not been able to generate any income from the port so far. Thus, SPA cannot practically fulfil any significant tasks on its sovereign territory because of lack of own service facilities (tugs, pilots, VTS, mooring boats, etc.). As a result the acceptance of the Supsa Port Administration among SPM customers seems low, and port dues which have been continuously demanded by the SPA have not been paid by vessel operators.

All claims for port dues have been denied by vessel operators, even efforts to arrest vessels in order to enforce the claim have not been successful. There reportedly have been instances where the Harbour Master of Supsa Port has been denied access to the vessels entering the waters of Supsa Port. For accessing the vessels, the Harbour Master depends on GPC allowing him to use their tugboat.

On behalf of vessel operators, GPC, backed by their mother consortium, so far rejects all responsibilities of SPA arguing that in fact Supsa Port is not a full-fledged port justifying the establishing a separate port administration with respective tasks, responsibilities and tariff rights. It is even questioned by GPC whether the Georgian Government had the right to establish a port administration charging vessels and thus effectively and unduly increasing the "tariff" for AIOC oil shipments through Georgia. According to PCOA and HGA concluded between the Georgian Government represented by GIOC (Georgia International Oil Corporation) and AOIC, the operator of the pipeline (and all related facilities, and thus also the Supsa terminal) pays to the Georgian State a transit fee ("tariff" as of Article 4.7 of PCOA) for every barrel of oil piped to Supsa across Georgian territory (currently about USD 0.20 per barrel). The operator claims that this transit fee also includes all fees and dues related to the offshore loading of oil into tankers. This transit fee seems low by international standards and has also evoked discontent by international financial institutions that considered that Georgia has missed a good chance to raise additional funds for the feeble state budget. With total cost of about USD 5.50 per tonne of crude oil across the Caucasus the Baku-Supsa pipeline surely is by far the cheapest transport alternative for Caspian oil to reach world markets. Even the construction of the BTC pipeline is not very likely to challenge this.

The Georgian side argues that Supsa port has been established by Presidential Decree and through the existence of a loading facility, no matter if offshore or onshore, Supsa in fact serves as a port. Moreover it is claimed that the Host Government Agreement covers only the fees up to the finalisation of the loading procedure, and is thus cargo related. Since neither the HGA nor the PCOA makes any explicit reference to the question of port and harbour dues, the Supsa Port Administration concludes that the vessels calling at Supsa are not included in this agreement and like in any other maritime country should be subject to the usual charges related to the utilisation of the countries maritime/port area. Thus, the Supsa Port Administration claims it has the right to levy charges on the vessels, as e.g. tonnage dues, lighthouse dues etc. It is not intended to levy charges on the terminal operator. The terminal operator seemingly defends the interests of his customers; to the knowledge of the consultants, direct talks between the Supsa Port Administration or the Georgian Government (as signee of PCOA and HGA) and the terminal operator on this matter reportedly have not been earnestly pursued.

The solution of this dispute is considered one major pre-requisite for further development planning in Supsa Port since it has an immediate impact on the funding and financing options of port development and construction. Plans and ideas currently circulating in the Georgian port sector foresee the construction of a LPG or LPG terminal as well as a rail connection to the port for the transshipment of oil. Moreover, the development of a solid infrastructure with piers, quay walls and breakwaters is envisaged.

4 Technical Analysis

4.1 Basic Principles of Port Dues

If a loaded cargo vessel calls at a port generally it is subject to two different cost and tariff categories: cargo- and vessel-related cost. Cargo-related costs (e.g. loading/discharging, storage, lashing, etc) are usually borne by the cargo owner. Vessel-related costs further subdivide into direct services and indirect services.

Direct services in many ports are provided by private companies as inputs and outputs can be exactly measured in financial terms and attributed to a single user/customer. These services comprise e.g. towage and mooring assistance, berthing and shifting, victualling, water and fuel supply, etc.

Inputs and outputs of indirect port services are more difficult to measure and usually not directly attributable/chargeable to a specific user, thus they are regularly not provided by the private sector but nevertheless necessary for port operations. These services comprise e.g. provisions for environmental protection, security and safety in port, maintenance of the aquaterritory (dredging), provision and operation of aids to navigation installations, medical services for seamen, etc.

Some vessel-related services can be part of either subdivision. For example piloting can be (at least partly) privately organised. Vessel owners then pay directly to the piloting service provider according to an agreed tariff. However, piloting can also be considered a sovereign task as it is related to security, and thus be under the responsibility of a government institution, e.g. a port authority. Another example relates to waste collection (e.g. of bilge water, garbage). Here costs for service provision can be relatively exactly attributed to the user, i.e. the vessel. However, in order not to give the vessel owner any incentive to discharge e.g. oily water into the open sea, waste collection is in some ports financially subsidised, in others strictly monitored and enforced (i.e. captains have to record where they discharged waste water). In any case, waste collection is very often considered as an item of indirect services.

Indirect port services are generally provided by public entities e.g. port authorities and other governmental institutions, and covered by so-called port dues. Port dues are charged in order to at least partly recover expenses for port infrastructure, water territory, and shipping and quay facilities.

Specifically, expenses to be covered include the following aspects:

- Lighthouses
- Aids to navigation equipment
- Roads and railway tracks leading to the port
- Quay walls
- Ensuring a certain depth of the harbour basins, dredging
- Services of fire department, water police, pilots etc.
- Oil spill fighting equipment
- Fire fighting equipment

Usually, a law is the basis for charging harbour dues. This law has to be adapted to changing conditions in the course of time.

The level of harbour dues is usually defined taking into account the following criteria

- The economic importance of the port for the city or the region or even the country in total. In general, the harbour dues shall cover the costs for provision of infrastructure for the ships. But also the economic impact of the port, the generation of jobs directly or indirectly by the port can be taken into account when determining the dues.
- The competitive situation of the port: if there is very hard competition for the port by other ports, this situation might also be taken into considerations, that is, there might be the decision that the harbour dues do not have to fully cover all costs.
- Market conditions: in individual cases the authorities might decide to give a discount in harbour dues, if in this case terminals and berths have a higher rate of utilisation.
- Increase of competitiveness
- Politically motivated promotion of special transport services, e.g. in Europe short sea shipping shall be furthered in order to change the modal split away from road transportation.
- Furthering of environmentally friendly ships
- Size of ships in Gross Tons (maximum: 80,000 Gross Tons)
- Ship type
  - Dry cargo ships
  - Tankers
  - Ro-Ro, car transporters
  - Reefer ships
  - Passenger ships
- Type of service
  - Liner service: coming with regular departures and have usually a lower utilisation rate than tramp ships. With the lower port charges a proportional equality between the proceeds shall be enabled.
  - Tramp ship

Harbour dues can also be used as a marketing instrument for a port. Not only the level of harbour dues can be a tool for attracting customers / shipping lines to a port but also politically, the harbour dues can give a signal. So, the port authorities can for example show that they keep environmental aspects in mind when they fix the level of charges.

Port Dues: The Case of Tankers in Hamburg

Due to the international demand to further the use of safer and environmentally friendlier tankers, in 1993 new tariffs / port dues for tankers have been introduced. The tariff for oil tankers was on the one hand increased, on the other hand, tariffs for oil tankers with separate ballast tank were reduced, and for oil tankers with a double hull they were reduced by 25%. In 1994 reduced tariffs for oil tankers with separate tanks for ballast water became EU law (regulation 2978/94).

A further change occurred in 1996. Then, the basis for harbour dues was changed from Gross Registered Tons to Gross Tons. Since 17.07.1994 all ships are being measured according the London Agreement of 1969. The German maritime authorities agreed in 1996 to change their basis for charges accordingly. The whole structure of harbour dues had to be re-organised, because there is no factor by which the GRT can be calculated into Gross Tons.

In addition to structural changes, the harbour dues were also adapted to changing environment. On the one hand, the expenses for provision of infrastructure had to be taken into account, on the other hand the competitive situation of the port. This led to the following development: in the years 1974 to 1998 an average between 1.5% and 10% took place, but in the years 1995 and 1996 and from 1998 to 2003 there was no increase at all.

Criteria for defining port dues are mainly:

- Levy charges for the use of infrastructure in accordance with the polluter/user principle as far as possible
- Direct relationship between the level of charges and the costs a user causes, including costs incurred on society, e.g. for environmental pollution.
- Promotion of an efficient provision of infrastructure

Expenses to be considered are operational costs, costs of damages at infrastructure facilities, costs for excessive use of infrastructure, ecological costs and costs occurring as a consequence of accidents.

Structure of Harbour Dues in the Port of Hamburg

1. Ships calling at the port of Hamburg for commercial purposes by loading/discharging freight or passengers and which cross the German sea border, have to pay harbour dues, which is calculated according to the Gross Tonnage (GT) of the vessel
2. Ships, which do not serve any commercial purposes, are exempted from the harbour dues. Exempted are further:
   - Ships up to a size of 1,500 GT, if they pay pilot fees on arrival at or departure from the port
   - Passenger ships travelling between the port of Hamburg and the German North Sea tourist towns, if their freight, without hand luggage and mail, has a weight of less than 10 tons
   - Fishing boats, transporting only their own catch
   - Ships, going exclusively to certain, specific areas of the port.
3. Ships with gross tonnage of between 1,500 and 4,000 pay a reduced fee of 50% if they pay pilot fees for harbour pilots. For ships larger than 80,000 only pay up to a gross tonnage of 80,000
4. In addition to the size of the ship the region of voyage, the ship's type and the type of service (liner or tramp) is also being taken into account.

Harbour dues are charged for stay in the port up to two weeks. Beyond that time, a special fee is levied. The harbour dues are calculated per 100 gross tons. For ships up to 500 gross tons for each 10 gross tons one tenth part of the tariff must be paid.

It is international practice to give discounts on vessels calling at a port; e.g. tankers qualify for discounts in the port of Rotterdam if

- they are equipped with segregated ballast tanks (discount of 17 percent on the vessel-size related part of the port dues)
- they fulfil the requirements of the so-called "Green Award" (discount of 6 percent on harbour dues)
- they call at the port of Rotterdam each second week or several times per week (frequent traveller discount, amounts to 10 percent if the ship calls each second week, 25 percent if the ship calls once or twice per week).

4.2 International Practice at Single Point Mooring (SPM) Facilities

An SPM installation is a mooring facility preferably located in some distance from the shore. It is connected to a pipeline and constructed to give larger tankers easy access to the oil facilities by decreasing navigational problems and facilitating the mooring. Furthermore, the usually big draught of the large tankers does not lead to problems if SPM facilities are used.

Mooring and loading can take place independently of wind and current, because the SPM can be accessed from any side and, therefore, frequently not even the assistance of tugboats for manoeuvring is necessary.

The consultants have interviewed representatives from major oil companies like ESSO, SHELL, MOBIL and STATOIL, each of which is operating SPM facilities, in order to get a clear picture on international practice at SPM facilities. The results of the discussions are described in the following.

- Presently, there are not many SPM facilities in operation, due to the fact that the largest and most modern tankers are necessary to access these facilities (e.g. the tankers have to have strong bow thrusters, positioning systems and manifolds at the foreship). There are SPM installations:
  - At the South American coast
  - In the Gulf of Mexico
  - In West Africa (Nigeria)
  - In the North Sea (Norway, Scotland and on the continental shelf
- By prolonging the pipelines the SPMs can be installed in deeper waters, so that they are very frequently located in international waters outside the seaside borders of a country.
- In order to avoid manoeuvring of large tank ships in harbour basins, only in rare cases is an SPM installed within port territories.
- Usually, the tanker, which is loading at the SPM, is being chartered by the company operating the SPM so that no costs for pilots and agents occur. The same applies for tug boat assistance and mooring services – the operators takes care of all these activities himself, so that the port cannot collect any fees for these services. Frequently, the pilot is also responsible for all loading activities and stays permanently on board until departure of the tanker.
- None of the oil companies which were asked ever had any problems with harbour dues, lighthouse dues, etc., because all these problems are avoided due to the special nature of SPM facilities (no port, no service provision by the port, own facilities, own administration etc.)

4.3 Evaluation and Conclusion of Institutional Analysis

The consultants' investigation shows that the options for SPA for levying charges on vessels calling at Supsa Port are rather limited. The following conclusion is based on above investigations, the consultants" experience and expert opinion as well as on the assumption that PCOA and HGA do not pose any hindrance in levying dues on vessels calling at Supsa.

It is obvious that operation, co-ordination and provision of floating material (support vessels) on high international standard must be the immediate priority of the seaport. Also the port has to provide security for customers as well for the state. All this stands for implementation of port structural and operational facilities and procedures together with modern communication and navigation equipment. It should be remarked that with a very small (or better non-existing) budget and with today's position "Supsa Port" cannot realise the above mentioned issues without financial, administrational and operational support.

The SPM at the port of Supsa, Georgia, is an installation of GPC, who takes care of operation, administration and management. That is, the whole installation, consisting of shore based oil tanks, pumping station, pipeline leading to the SPM, the SPM itself, administration, fire and oil fighting equipment, as well as mobile facilities like tug and mooring boat and pilot service, staff responsible for pumping, radio and radar installations and agency services are being provided for by BP and operated by their own personnel.

If this situation remains unchanged, the only potential chance for Georgia to charge any fees and dues (if confirmed by the appraisal in Chapter 5) relates to common service charges (tariffs for using governmental and port infrastructure) usually based on the GT (gross tonnage) and the period the tanker stays within the

port or country borders. In this case, it would have to be legally defined if these charges are to be levied starting from the entrance into national waters or only when the harbour border has been passed. In order to do so, the harbour borders of Supsa would have to be clearly and legally defined and internationally published.

In fact, the decree to establish Supsa Port Administration also included the official establishing of Supsa Port. The port area is clearly defined by drawings. Thus, SPA as an established port administration would now have the right to levy charges in line with Georgian maritime legislation and according to tariffs determined by the Georgian National Maritime Administration. If now the right of SPA to levy charges in Supsa is denied there are several aspects to take into account.

- Is there any legal agreement superseding or in contradiction to the decree to establish Supsa Port and the Georgian maritime legislation, which exempts any user of Supsa SPM from paying any dues? This question relates to the appraisal part of this document and will thus not be further considered here.
- Is levying charges on vessels at facilities like in Supsa against international common practice and standards?
- Is SPA the right institution to collect charges from vessels?
- Is SPA not acknowledged as a serious party by international vessel owners/charterers calling at Supsa?

A direct comparison with places where similar conditions as in Supsa prevail is rather difficult as no information could be obtained on the underlying legal agreements. The key parameters of these agreements were generally considered confidential but as the oil companies participating in AIOC have ample experience in drafting and concluding agreements like PCOA and HGA it can be assumed that the latter two agreements will not significantly differ from similar agreements in other parts of the world. However, it was made quite clear that none of the major players currently operating facilities like Supsa did pay any port dues (simply because there is not any port) or had any other problems related to paying dues for operating the SPM, at least not officially.[1]

Moreover, the nature of SPM offshore facilities like Supsa usually avoids any conflicts with port authorities as these facilities

- have been constructed far outside the area/vicinity of any port for navigational purposes at places where there is only very limited or no demand for port facilities in the narrow sense. The operator of the SPM facilities is not very much interested in further third-party development of the site, as it would not add further benefit to his operations.
- are intended to serve only a very restricted, clearly defined group of users for a single commodity (which somehow contradicts the idea of a port). The terminal and all related installations are directly or indirectly operated by the oil producing entity. The transshipment operations are "charged" according to cost prices and thus are a mere cost item of the oil production process, i.e. the terminal is expected to provide services at low cost, not to make profit;
- are not required to serve diversified and sophisticated logistical functions. Demand for transhipment services is fixed and usually determined by the production rate of the connected oil wells.
- are very limited in size and scope and thus relatively easy to monitor. In case of default, responsibilities for default are easy to attribute.

[1] Having considerable consulting experience also in the African port sector, the consultants cannot rule out that there are unprinted tariffs paid for calling at SPMs.

In other words, it seldom happens that an SPM facility later develops into a nucleus for port development. During their research the consultants did not come across any prominent example. In so far the situation at Supsa can be even considered unique.

Even the case of nearby Batumi cannot be directly compared to Supsa, yet provides some insight into shipping psychology. In Batumi the construction of the SPM has become necessary as the existing terminal facilities for oil handling were running close to full capacities, there was only very limited space for further extension, and the existing port basin clearly restricted the size of tankers handled at berth. The SPM was considered a very cost competitive alternative to dredging the port and developing new terminal facilities. In fact, the SPM is very close to the port basin, less than 200 m away and thus integral part of the port existing structures. Clearly, an SPM thus close to the shoreline and the core port structures need to be monitored by an existing port authority. As vessels and vessel owners can take advantage of all existing port facilities and services they are willing to pay regular port dues independent of whether the vessel is handled at berth or at SPM. The perception of the customer is not that they are calling at Batumi SPM but at Batumi port.

Moreover, Batumi Oil Terminal is a multi-user facility with a terminal operator who has no own direct interest in oil producing and owning. His core business is to run profitable terminal operations for all customers applying for transshipment of their oil cargoes. Any measures to increase the attractiveness of Batumi port (e.g. regarding hinterland transportation modes) will also enhance his business potential.

In Supsa however, there are no visible port structures, no services available other than those provided by the terminal operator. The SPM is two nautical miles away from the shoreline. Maintenance of the aquaterritory does not seem necessary. So, vessel owners or rather their charterers would ask themselves why paying? To declare a certain area and aquaterritory a port does not necessarily make a port in the perception of the vessel owners.

Clearly, these vessel owners calling at Supsa do not take into account that some governmental infrastructure services are indeed provided such as

- search and rescue
- environmental monitoring
- medical service
- meteorological service
- aids to navigation
- national maritime administration
- safety and security of operations in Georgian aquaterritory (water police)

So, in principle there is a good case to claim certain dues for a.m. services from vessel owners. It is however arguable if these dues need to be collected by a separate port administration for Supsa or rather by the existing port administrations of Poti and Batumi (e.g. today the Harbour Master of Supsa is at the same time the Deputy Harbour Master of Batumi) as the above fees are raised for common governmental services usually provided and maintained by others than port administrations.

For example maritime search and rescue services are operated by a specific entity in Batumi for all Georgia. All Georgian ports (i.e. all commercial vessels calling at Georgian ports) should contribute to the cost of this entity according to the volume of their business activity (e.g. as measured by total gross tonnage calling at the port). Fees collected should be directly transferred to the search and rescue centre in Batumi.

Another example relates to the budget of the National Maritime Administration (NMA). The NMA coordinates and usually supervises the port authorities and is responsible for the enforcement all laws and regulations

related to Georgia's maritime affairs. The budget for the NMA should be established by a fee raised from vessels calling at Georgian ports. Fees could be either collected by port administrations and then be transferred to NMA or directly paid to NMA. In Poti for example vessels from 500 GT upward need to transfer USD 100 to the bank account of the NMA.

Is there now a case for a port administration in Supsa? This question relates to the question of raising port dues in Supsa, especially tonnage dues that usually constitute a rather large element in port dues, and is of major concern for the existing Supsa Port Administration.

Vessel owners could argue that in the absence of common port facilities and equipment it becomes questionable why there should be a special port administration to manage these non-existing facilities. The establishing of a separate port administration (for currently 60 vessels a year) would only incur additional costs e.g. in form of staff cost for management, accounting, engineering, planning, billing, communication and other administrative functions, without adding any benefits to their business.

The argument that the existence of SPA is justified by projecting and constructing a new port in Supsa is understandable. However, the follow-up argument that SPA thus needs to levy significant port dues on current users of the SPM facility as they intend to finance future port development from those dues seems a bit weak in the light of international practice, where usually port infrastructure investment is re-financed from port income rather than pre-financed. In many cases port infrastructure is financed by the public hand. Port dues are then intended to mainly cover maintenance and repair, capital cost and depreciation, and operating cost since port administrations are usually designed as non-profit organisations.

However, sometimes it is advisable and good practice to include a small expansion component in the port dues in order to generate funds for future development of new or upgrade of existing facilities. Thus, there may be a justification for small port dues if SPA would be able to raise funds from private sources or state budget for initial infrastructure construction work or acquisition of common port equipment. A visible sign of port structure would significantly enhance the status of SPA and "convince" customers that Georgia really is about to construct a new port in Supsa rather than just finding another way of raising money for the state budget (even though tanker owners and their charterers will be difficult to convince as in the short and medium term they are not likely to profit very much from the then higher cost of calling at Supsa SPM).

Moreover, political support for SPA could be more pronounced in Georgia. The attempt of SPA to arrest a vessel in order to enforce charges levied on a tanker was unsuccessful as the tanker was freed within hours through intervention of other Government institutions.

The question of levying charges on vessels in Supsa has been unresolved for quite some time now. So far, the consultants have got the impression that the Government follows a very cautious approach in supporting SPA against the terminal operator in Supsa, which is understandable given the importance of AIOC (as the mother consortium of the terminal operator) for the state budget. A direct confrontation between the Government and AIOC has been avoided; reportedly direct negotiations have only reluctantly been initiated to resolve the problem. It seems that contacts so far have been restricted mainly to the exchange of position papers and legal opinions. Moreover, the consultants understands that the Georgian side has not yet undertaken to ask a specialised and internationally renowned law firm for a full legal opinion.

All in all, the evaluation of above arguments indicates that the immediate contribution of tankers currently calling at Supsa to the SPA budget can only be very limited, probably just enough to secure rudimentary operations. In order to grow, SPA has to enhance their marketing and business development capacities to find private investors, which they can convince with a comprehensive concept. Given the usually expected

positive effects a port has on the regional and national economy, SPA should receive further (but timely limited) support from the state budget to develop and market a comprehensive concept for Supsa Port.

It should be stressed that independent of the Governmental decision execution of project tasks as foreseen in the Terms of References can provide valuable results for further development of Supsa Port Administration as it can be expected that irrespective of the resolution of the BP dispute SPA will have to fulfil important tasks related to port state control, control of the aquaterritory, environmental protection, navigational safety.

5 Appraisal of the Exemption from "Taxes" under the HOST GOVERNMENT AGREEMENT and PIPELINE CONSTRUCTION AND OPERATION AGREEMENT

5.1 Introduction

The expressions "Host Government Agreement" and "Pipeline Construction and Operation Agreement" are abbreviated throughout to HGA and PCOA respectively.

The PCOA and HGA have been considered in the context of the present controversy over the possible liability of the Oil Companies and their carriers and contractors to pay fees of various descriptions to which the Supsa Port Administration claims to be entitled and in respect of which the Oil Companies claim to be exempt.

No consideration is given in this report to the issue of whether particular services are in fact being provided or whether particular operations fall within fee categories imposed by legislation or contract. Such consideration would be premature when the basic issue of entitlement to levy port fees has not yet been clarified. This document therefore considers the far-reaching rights and obligations of Parties to the HGA and PCOA, many of which are stated to take precedence over the rights which local Georgian interests might otherwise enjoy under the laws of Georgia, as a contribution to the discussions which have already taken place between the different interests.

This report is not a legal opinion as the Consultant is not contracted to provide legal advice. The report is an impartial qualified appraisal of the provisions in the HGA and PCOA in the context of the positions adopted by Georgian interests and the Oil Companies. It is hoped that it will provide useful guidance to both sets of interests in the further consideration of the issues which they need to resolve and which the Consultant considers would be most appropriately taken forward by means of conciliation or mediation rather than by unilateral action on either side or by formal arbitration in which one side is bound to lose. It may also serve as a useful aide-memoire to lawyers representing the respective interests.

5.2 Intention of the Parties to Include Export, Loading and Vessel Operations in the Scope of Their Agreements

Comment has been made by the Parties as to whether export, loading and vessel operations were intended to be or are within the scope of the agreements. The Georgian side broadly contends that vessel operations were neither intended to nor are within the scope of the agreements, while the Oil Companies contend that they were and are within scope. The Georgian side further puts very restrictive interpretations on the meaning of export and loading operations, terms which they point out are not specifically defined.

5.2.1 Recitals in Preambles

There is probably not a common legal approach under English and Georgian law to recitals in preambles to legal documents. Only limited notice may probably therefore be taken of the recitals incorporated both in the HGA and the PCOA in considering the intention of the Parties, in accordance with Article 13.1 of the HGA.

The preamble to the HGA refers specifically to a marine export terminal and Facilities (Facilities having the same meaning as in the PCOA) which are, or shall become state property. The PCOA recites that the oil companies desire the right to transport and export petroleum through and from the Facilities.

5.2.2 Definitions

There are further indications of an intention to include marine operations contained in the definitions clauses in the PCOA. Thus the construction completion date is defined as the *"date on which the facilities first constitute an integrated....marine export system...capable....of exporting (petroleum) using marine vessels".* Also Removable Facilities means *"the Floating Offtake unit"* while Terminal means the *"proposed new marine export terminal ...including any associated onshore and offshore moorings".*

5.2.3 Body of the Agreements

Article 4.2 of the HGA refers to exit rights and rights to enter water while Article 5.4 (e) of the PCOA refers to bills of lading and deliveries of petroleum on board marine vessels at the terminal. Article 8.4 refers to sea and river beds and Article 9.1 to the sea.

5.2.4 Conclusions

The words used in the agreements suggest that there was an intention to include the use of the marine terminal and its associated pipe-work and moorings by marine vessels in the HGA and PCOA and that such operations are also covered under the definition of "Pipeline Operations" under both agreements. However, vessels themselves do not seem to be directly included in the definition, but may be indirectly included as activities "related" to the operation of the Facilities, or other activities conducted pursuant to the agreements.

Pipeline Operations means *"the activities conducted in Georgia by the Operating Company, the Oil Companies, their Affiliates or their officers, employees, agents, representatives or Contractors, that are related to ...(ii) the operation of the Facilities....(v) other activities conducted pursuant to"* (the agreements).

It will be apparent from the section below that "Facilities" specifically include all aspects of the new marine terminal envisaged by the agreements and that Article 9.2 of the HGA refers to the activities of carriers engaged by the Exempt Parties or other owners of Petroleum. However the likelihood that loading and export carriage activities are embraced by the agreements is not in itself conclusive in any way that special exemptions apply in respect of Port service fees. These exemptions must be separately considered to see whether or not they apply to marine activities.

5.3 Export Operations: Exemption from Taxes

Article 9(2) of the HGA appears to have been inserted specifically to clarify the status of export operations in relation to exemptions from "Taxes". It is headed "Petroleum Export" and states *"The Exempt Parties, own-*

ers of Petroleum and their carriers shall have the right to freely import and export, free of all Taxes any Petroleum which is, or is to be, transported through and exported from the Facilities".

5.3.1 To Whom Do the Exemptions Apply?

The clause seems to mean that the oil companies, any other owners of petroleum and their respective carriers are all exempt from "Taxes" in relation to the **export** of petroleum.

The nature and identity of both "owners of petroleum" and "carriers" may be established as a matter of fact in any given situation involving an export movement.

The Georgian side contends that the legal carrier of oil is frequently not the vessel owner or the vessel operator, but some other intermediary. In such cases they contend that exemptions from "Taxes" would not apply to the vessel owner or operator because it was not a "Carrier" and that port service fees may therefore be levied from such parties.

In the alternative, they contend that export is completed at the terminal when export documentation and the bill of lading is made out, and that the carrier referred to in Article 9.2 can only be the pipeline operator which imports the oil and transports it to the SPM. They contend that the maritime carriers intervene after the process of export is complete and "Taxes" on vessels therefore do not arise in relation to the **export** of petroleum, but after export, and so are not exempted by the agreements.

An Arbitrator would therefore need to rule on what is meant by the word "export", and whether this process requires vessels to accomplish it or whether it is complete at the SPM when documentation is completed. The word is not further defined in the agreements, but the Shorter Oxford English Dictionary gives "send to another country" and Webster gives "to carry or send to some other place (as another country)". The Georgian side may therefore face the task of showing that a more specialised and restricted meaning is intended and that export does not in this case require the petroleum physically to leave the country, but only to reach the end of the SPM. If this restrictive interpretation were accepted, Article 9.2 might be found not to apply to Taxes imposed for activities beyond the end of the SPM.

An Arbitrator would also need to rule on the meaning of "carrier" and the Georgian side might have to justify why it was not restrictively defined in the definitions clauses as its ordinary meaning would normally clearly include a maritime carrier.

5.3.2 When Do the Exemptions Apply?

The exemptions under Article 9.2 apply to petroleum **exported** from the Facilities. The Article does not deal with exemptions related to Pipeline Operations more generally, which are dealt with in Article 5. The HGA adopts definitions of "Facilities" from the PCOA and these are quite complicated.

<u>The Definitions clause of the PCOA states that:</u>

- **Facilities** means the *"Existing Pipeline Facilities together with the new facilities as existing from time to time".*
- **New Facilities** means *"the pipeline, marine export terminal and all ancillary facilities described in Part B of Schedule 1".*

Part B of schedule 1 includes at B(ii) *"the proposed new marine export terminal on the Georgian Black Sea coast including any associated onshore and offshore moorings...as well as onshore and offshore flow lines"* and B(vi) *"any floating storage offtake unit and associated facilities for the receipt, storage and loading of Petroleum as well as the mooring of marine tankers".*

These definitions appear to describe the marine terminal built at Supsa. The question remains as to whether the entire terminal at Supsa comes within the definition of "Facilities" in respect of which Taxes exemption is granted. It is therefore necessary to consider a further definition in the PCOA, that of **Removable Facilities**. This means *"the floating Storage Offtake unit referred to in Part B of Schedule 1".* Thus via the definition in Part B of Schedule 1, removable facilities seem to be brought into the definition of New Facilities, themselves embraced in the overall term defined as "Facilities". It may be concluded that the entire physical operation at Supsa does seem to come within the definition of "Facilities" under both agreements. Further confirmation of this is to be found in Schedule 3 of the PCOA which refers to Proposed New Facilities south of but adjacent to the mouth of the Supsa river consisting of offshore pipelines, a PLEM, riser hoses, an offshore loading mechanism such as a CALM buoy etc.

However, vessels do not seem to come directly within the definition of Facilities. The Georgian side draws the conclusion from this that vessel activities do not come within Article 9.2 or within the definition of Pipeline Operations either and so could not benefit from the Article 5 exemptions for contractors.

In considering "Pipeline Operations" and whether these exclude vessels, an Arbitrator would have to decide whether vessel operations were nonetheless activities "related" to Pipeline Operations or other activities conducted pursuant to the agreements. It is of course possible that he might take the view that vessel operation was unrelated to operation of the Facilities themselves, but in view of the direct physical connection made between tanker vessels and the Facilities this would require him to take an extremely restrictive interpretation of the word "related".

5.3.3 What Is Meant by Taxes?

Taxes means *"all levies, duties, payments, fees, taxes or contributions* ***payable to or imposed by the Government*** *or ecclesiastical authorities within Georgia".*

It should be noted that according to Article 15 of the HGA, *"in the event of any conflict in interpretation of any provisions as among the different language counterparts, the English version shall control".* Particular importance can therefore be given to the words which appear in English in this important definition. On the other hand the doctrine of "contra proferentem", ie that words will be construed against the Party at whose suggestion or insistence they were included, would appear not to be relevant. Article 20 (4) of the PCOA states that *"in construing this agreement, no consideration shall be given to the fact or presumption that one Party had a greater or lesser hand in drafting this agreement".*

It would appear that the definition is intended to extend beyond the ordinary meaning of the word tax which is defined in the Shorter Oxford English Dictionary *as "a contribution to state revenue, compulsorily levied on people, businesses, property, income, commodities, transactions etc".* This greater scope is particularly obvious in the reference to **payments** and **fees** which terms would more frequently be applied in relation to services (or what the French refer to as "prestations") according to the extent of use rather than to taxes as ordinarily understood. The question which arises is whether the language used is wide enough to cover the charges normally made to port users, which may fall into a number of categories, as outlined by the Georgian side in its position statement of 17 May 2002.

It is notable that the word "dues", often used in relation to port charges, does not specifically appear and it is worth considering whether any significance may be attached to this omission. It may firstly be remarked that the Georgian side itself does not refer to "dues" in its submissions so that the term is perhaps not in issue. Secondly the draftsmen avoided the use of a "wrap-up" phrase often found in agreements after a list of items referring to "other similar/like" levies. They may have kept the list tight and wide at the same time in order to avoid arguments over semantics and categorisation of "levies" "fees" etc and whether a particularly named charge was or was not exempt. Thirdly the Shorter Oxford Dictionary gives a definition of "dues" as "an obligatory payment, a fee, a tribute, a toll". It may be seen that port dues would seem naturally to fall within the category of "fees" mentioned in the exemption even if the term of art, "dues", has not been included in this instance. The same dictionary includes in its definition of "fee", references to "the sum payable to a public officer for the execution of relevant duties", which would seem to embrace the duties of a body such as a Port Authority and its officials. Furthermore, Payment is defined as the "act or process of paying". This is such a wide activity as arguably to apply to any situation where any kind of charge is normally made.

The above would tend to support the view that all intermediate payments connected with the **export of petroleum** *"payable to or imposed by Government"* were intended to be commuted into the payment of the agreed and defined "Tariff" under the PCOA at Article 4.7. This states *"Save as otherwise expressly provided in this Agreement and the HGA, the Tariff shall be the **sole compensation** payable to GIOC, its Affiliates or the Government for the **use of the Facilities** and the grant of rights by GIOC under Article 3 and Clause 8.4".*

In making his adjudication, the Arbitrator would probably also need to decide whether Article 4.7 of the PCOA mentioned above, with its reference to the *'use of the Facilities'*, should be taken into account in making any interpretation of the overall effect of Article 9.2. He might need to rule on whether or not tanker vessels can be regarded as "using" the Facilities. If he ruled that "use of the Facilities" includes their use by tanker vessels, the tariff might be regarded as including any fees associated with that use, leading to the same outcome as if such use were exempt from Taxes. He might also need to rule on whether the establishment of a port authority and collection of fees from vessel owners and operators (if found by him not to be carriers) materially affected the rights of the oil companies by increasing their costs. This might entitle them to recover provable extra costs (if any) from the Government in accordance with Article 4.1 (g) of the HGA.

However, the Georgian side suggests that, subsequent to the entry into force of the PCOA and HGA and prior to the refusal to pay fees to Supsa Port Administration (and also since that time), the oil companies' contractors have consistently paid vessel and port dues at the ports of Poti and Batumi, also airport taxes and road transit fees, thereby appearing to acknowledge that such transit related fees were not intended to be, and were not included in the definition of "Taxes" which were the subject of exemption. As it is suggested that this conduct continued for several years and still apparently continues, an Arbitrator might be more prepared to consider that such fees were not intended to be exempted as "Taxes" in spite of the wide nature of that definition. He might also need to consider whether the oil companies had forfeited the right to rely on the waiver provisions in Article 15.2, because of their apparently persistent conduct in not claiming exemptions, should he find them to have been notionally entitled to exemptions.

5.3.4 What Is Meant by Government?

It is important to note that only "Taxes" *payable to or imposed by Government* are the subject of exemption. "Government" is very widely defined in both agreements. The definition may be broken down as follows:

Government means

- *"The Government of the Republic of Georgia and any political or other sub-division thereof including its ministries;*
- *Any Republican, national, regional,* ***municipal or local government*** *or other representative agency,* ***official body or authority****;*

which has the authority to govern, legislate, ***regulate****, levy and collect taxes,* ***fees*** *or duties,* ***grant licenses and permits****, approve or* ***otherwise impact*** *(whether financially or otherwise)* ***directly or indirectly****, any of the Georgian Party's, the Oil Companies', their Affiliates, the Operating Company's and their Contractors' rights, obligations or activities under this Agreement"*

It seems likely that a Port Authority, however designated, established by national legislation or under municipal bye-laws, or a combination of both, would be considered an official body or authority, having the authority to regulate certain activities and to levy fees to defray its running costs. As such it would fall within the scope of the definition of "Government" under both agreements. Port dues and charges of all kinds in relation to the **export of petroleum** might therefore be payable to or imposed by "Government" within the meaning of the definition and as such could be exempt under the agreements because they constituted "Taxes". However, the issue would remain to be decided, as mentioned above as to which activities were included in export of petroleum and whether the "Taxes" definition is wide enough to exempt the oil companies from port fees in relation to those activities.

Even if Supsa Port Authority is an entirely private operation in no way connected with national or local government and also not in any way an official body or authority, (which does not appear to be the case) it is stated by the Georgian side that it was established by Presidential Decree of 31st May 1999. The Consultant has not yet seen the Decree but would mention that the authority for Supsa Port to make charges may be drawn from the Decree and this could also bring those charges within the definition of "Taxes" even if the port is not run by 'Government'.

An issue remains on 'Taxes' which might have to be the subject of legal adjudication. This is whether the GIOC and Government of Georgia have the constitutional right to ensure compliance by subordinate institutions with the exemptions in the HGA and PCOA or whether those institutions are constitutionally directly bound by the HGA and PCOA to allow the exemptions. A further issue for legal adjudication could be whether or not subordinate institutions are entitled to any internal compensation within Georgia from the GIOC and/or the Government of Georgia in respect of their obligations to allow exemptions from 'Taxes' to the *'Exempt parties, owners of petroleum and their carriers'*. An Arbitrator might have to consider testimony from experts on Georgian constitutional law on these aspects.

5.3.5 Conclusion

Whether port service fees of a Port Authority operating within the area of the Oil Companies' activities at and around the marine terminal at Supsa, related to the export of petroleum, are included in the wide exemption from taxes, would have to be subject to conclusive adjudication of what operations are included in the **export of petroleum**.

The conduct of the oil companies' contractors in apparently paying various transit fees over a long period of time in spite of possible exemption from these "Taxes" also raises challenging issues for an Arbitrator.

Finally the issue of the overall tariff established by Article 4.7 of the PCOA would need to be considered in relation to possible "use" of the Facilities by tankers, while the establishment of a port authority to regulate

the closed activities of the oil companies at Supsa raises further issues related to applicability of Article 4.1.(g) of the HGA.

5.4 The Effects of Conflict between the HGA and PCOA and Domestic and Other Legislation

5.4.1 Warranties and Guarantees

Both the HGA and PCOA contain warranties and guarantees intended to ensure that the rights conferred on the Oil Companies as to possession and use of the Facilities and charges-free export of petroleum therefrom should be maintained throughout the whole term of both agreements. This intention is specifically stated in Article 4.1 (g) of the HGA: *"It is the intention of the Parties that no future law, decree, administrative order of Georgia or the Government* (which expression is defined to include Central Government, a relevant municipal administration, official body or authority) *shall amend, repeal or take precedence over the PCOA/HGA unless it contains an express provision to that effect".* Furthermore should such future laws have any adverse effects on rights granted *"the Government shall indemnify the Oil Companies for any disbenefit, deterioration in economic circumstances, loss or damages that ensue therefrom".*

Under Articles 3 and 4 of the HGA, the "Government"

- Warrants that it has sole and exclusive jurisdiction over the facilities at Supsa and that no other party has conflicting rights
- Agrees to maintain sole and exclusive jurisdiction over the Facilities for the lifetime of the PCOA
- Agrees not to grant any rights to use the Facilities except as expressly provided in the PCOA
- Agrees at no time to enter into or ratify any treaties, intergovernmental agreements or any other arrangements which would...diminish, infringe upon, nullify or derogate from the rights...of the Oil Companies under the PCOA
- Agrees not to grant...any rights to use the Facilities except as expressly provided in the PCOA
- Agrees to ensure that the PCOA shall take precedence over any **current** law, decree, administrative order, legislative act...which is inconsistent with or conflicts with the HGA or PCOA
- Agrees to ensure that rights shall not be amended, modified or reduced without the prior consent of the Oil Companies
- Irrevocably and unconditionally guarantees the rights granted by GIOC under the PCOA

Under Article 13.1 of the PCOA, GIOC warrants that it shall have *"authority...to perform this Agreement, to grant the rights and interests to the Oil Companies as provided under this Agreement and to fulfill its obligations under this Agreement".*

If any breaches of warranty could be proved, the Oil Companies would appear to be entitled to claim under these guarantees. There might need to be legal adjudication on constitutional as well as contractual issues as to whether such action should be taken directly against GIOC and the Georgian Government or directly against subordinate institutions if it is they who appear to be in breach of warranty.

5.4.2 Practical Effects of Warranties and Guarantees and Any Conflicting Provisions

Comment has already been made on the definition of "Government" which appears to be intentionally much wider in scope than the state government and its ministries. The use of the defined term is a little strained at times for example where references are made to "sole and exclusive" jurisdiction when the jurisdiction may in fact be shared between a number of institutions.

The state of Georgia and GIOC appear to have acted as "agents" for, or under the deemed authority of, a very wide range of bodies and to have warranted or promised that both they and those bodies would not interfere with the mechanics of land possession and use for "Pipeline Operations" or with the mechanism of the Tariff and from exemptions from "Taxes", by retaining or making new laws or regulations which could reduce or nullify the exemption from "Taxes".

Any difficulties of interpretation appear to relate mainly to possible internal conflicts of jurisdiction between the Georgian Government, GIOC, regional and municipal authorities and other official bodies and authorities such as Supsa Port Authority. They may be more relevant to settlement of differences which could arise between those parties than the relationship of those parties with the Oil Companies. The wide definition of "Government" used in the agreements may have been selected precisely to separate off such possible internal conflicts so as to leave the functioning of the agreements unaffected, but the issue of the effectiveness of such an approach remains one which could nonetheless require legal adjudication.

It should be noted that the "Tariff" has a sophisticated escalation mechanism but that the possibility of rebasing it to take account of changed circumstances is given only very infrequently under Article 20 of the PCOA. This suggests that the Tariff may have been considered to provide robust revenues sufficient for the state Government of Georgia to deal internally with any minor adjustments arising from the actions of any of the institutions embraced by the term "Government" used in the agreements. If it wished to, it could legislate to restore the status quo and might choose to implement some measure of internal compensation of the affected Georgian party for this return to the status quo. If not it would have to compensate the Oil Companies for any disbenefits suffered. Article 4.1(g) of the HGA earlier considered, concludes by placing the responsibility firmly with the Government to take *"appropriate measures to resolve promptly…any conflict or anomaly"* between the HGA/PCOA or the HGA/PCOA and other laws.

5.4.3 Conclusion

It would appear from the above that, under the PCOA and HGA, the State Government of Georgia should modify any of its own laws which conflict with rights given under those agreements. Having been included within "Government" under the agreements, other official bodies and authorities also appear to be under a duty to modify their regulations and orders to avoid conflict. If any of these bodies are nonetheless in a sovereign position to act as they choose and elect to act in derogation of the agreements, the State Government of Georgia and/or those other bodies, appear bound to indemnify the Oil Companies for any disbenefit, deterioration in economic circumstances, losses or damages arising from their actions and which relate to the Taxes exemption.

Relating this back to the situation under Article 9.2 of the HGA in which *the "Exempt Parties, owners of Petroleum and their carriers shall have the right…to export, free of all Taxes any Petroleum which is, or is to be….exported from the Facilities"* at Supsa, it would appear that any attempt to recover fees from these entities, related to the **export of petroleum**, through legislation or administrative order, will be in conflict with the agreements and that any such legislation should accordingly be modified to restore the status quo. Alternatively, if the laws of Georgia indicate that the Supsa Port Authority and its charging scheme are lawfully constituted and if that Authority were found by an Arbitrator to be in derogation of the HGA and PCOA, the Georgian side might need to agree internally who is to compensate the Oil Companies for any infringement of the agreements. The Oil Companies might look to the State Government of Georgia for such compensation if it were proved that tanker vessel operations were exempt from "Taxes" or that the oil companies had been materially prejudiced.

5.5 Other Points to Be Taken into Consideration

5.5.1 Ambiguities in the Agreements

It is only the Exempt parties and owners of petroleum **and their carriers** who benefit from the exemption from "Taxes" under Article 9.2 of the HGA. These classes include Affiliates of the Oil Companies but do not include their general contractors. A situation could therefore arise under Article 9.2 where such contractors would not be exempt from "Taxes" if they were not also carriers, for example if they were only terminal operators. In those circumstances, and any circumstances unrelated to export of petroleum, it would be necessary to consider the effect of Article 5 of the HGA, which gives additional exemptions from 'Taxes'.

Article 5 mainly concerns taxes in their generally accepted meaning rather than the wider meaning created by the definition of "Taxes" in the HGA and PCOA. Thus it deals with such matters as VAT.

It would, however, appear from Article 5.1 that **Exempt Parties and owners of petroleum** are exempt from "Taxes" in relation to:

- the Facilities (ie the marine terminal and offtake unit)
- Pipeline Operations which means *"the activities conducted in Georgia by the Operating Company, the Oil Companies, their Affiliates or their officers, employees, agents, representatives or Contractors, that are related to ...(ii) the operation of the Facilities....(v) other activities conducted pursuant to"* (the agreements)
- Export of petroleum through the Facilities

This seems to amount to a granting of similar and possibly wider exemptions than those under Article 9.2 but to a more limited class of entities, as carriers are not direct beneficiaries.

The class enjoying direct exemptions seems to be widened by Article 5.3 (a) which states that *"**Foreign Contractors** shall be entitled to full and complete exemptions from all Taxes in respect of Pipeline Operations".*

Contractor means *"any natural person or juridical entity supplying **directly or indirectly**, goods, work or services to the Oil Companies or the Operating Company...related to Pipeline Operations".*

Article 5.3 (a) thus appears to grant exemption from "Taxes" to an additional and wide class of entities, 'Contractors', which could include carriers and terminal operators engaged in activities related to the operation of the Facilities at Supsa. It should be noted, however, that only Foreign Contractors would appear to benefit from the exemption, such contractors being defined as persons not being Georgian citizens and bodies incorporated outside Georgia.

5.5.2 Exclusive Jurisdiction

The oil companies contend that because they were given rights to possession and use of the Facilities along with the right to operate the Facilities, they may thereby exclude the jurisdiction of a public authority over those activities. It, however, seems unlikely that the rights granted were intended to or did affect Georgian sovereign rights in any way and more likely that the provisions were inserted merely to reassure the participating oil companies that similar rights of use would not be granted to competitors not party to the agreements. Furthermore, under Article 4.1 (b) of the HGA the Government in fact warrants that it will maintain sole and exclusive jurisdiction over the Facilities.

5.5.3 Conclusion on point 5

It would appear that Exempt Parties and owners of petroleum may benefit from the exemption from "Taxes" under Article 5.1 of the HGA in relation to a wide range of circumstances, including Pipeline Operations, irrespective of the position under Article 9.

According to the wording of the agreements, foreign Contractors, which may include carriers and terminal operators, also appear to benefit from the exemption from "Taxes" under Article 5 of the HGA irrespective of the position under Article 9.2 which concerns only Contractors who are carriers. Article 5, however, appears to disallow exemption from "Taxes" in the case of Georgian Contractors but according to Article 5.3 (c), Exempt Parties shall have no liability for any default by such Contractors in relation to payment of "Taxes" in respect of which those Contractors are not exempt.

A final issue which may require legal adjudication concerns contradiction, overlap or inconsistency between the provisions in Article 9.2 and Article 5 of the HGA and its legal effects. Thus under Article 9.2 all carriers are apparently exempt from 'Taxes' on the export of petroleum, while under Article 5 only Foreign Contractors are stated to be so exempt. An Arbitrator might have to decide on the status of the rights granted under Article 9.2 and whether they were additional or alternative to those under Article 5 which is the main article dealing with 'Taxes'.

6 Overall Evaluation of the Situation

The appraisal of the documents reviewed in the course of the present analysis reveals that there is some ambiguity in several aspects crucial to the interpretation of the HGA and PCOA with respect to levying charges on tankers calling at Supsa. It can be assumed that at the time of drafting these agreements the question of vessel charges has not been explicitly discussed between the contracting parties.

The consultants opine that the identified aspects may not be sufficient to guarantee a positive outcome for the Georgian Government in a probably lengthy and costly arbitration process. However, the consultants are confident that GPC as well as the Georgian Government will be interested to settle the current dispute during a mediation, which might enable both sides to find an acceptable solution.

The technical analysis generally supports the appraisal of the Agreements. The identified practical aspects may be of relevance and importance during the mediation process. However, during an arbitration, which focuses on the legal side of the problem, these arguments will most probably be neglected.