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GAS DIVERSIFICATION POLICY OF GEORGIA

ROLE OF EXTERNAL ACTORS - AZERBAIJAN, RUSSIA AND IRAN

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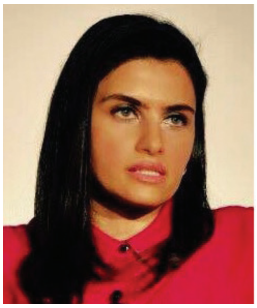

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ABBREVIATIONS

bcm/a	billion cubic meter annually
BTE	Baku–Tbilisi–Erzurum gas pipeline
CSO	civil society organizations
EEC	European Energy Community
EEU	Eurasian Economic Union
GABB	Gazimagomed–Astara–Bind–Biand pipeline
GD	Georgian Dream
GOGC	Georgian Oil and Gas Corporation
GGTC	Georgian Gas Transportation Company
GGGS	Gazimagomed–Gazakh–Gardabani–Saguramo pipeline
HPP	Hydro Power Plant
IAGP	Iran-Armenia gas pipeline
IGA	Intergovernmental Agreement
JSC	joint-stock company
LTD	limited company
mcm/a	million cubic meter annually
MoE	Ministry of Energy
MoU	memorandum of understanding
NIGC	National Iranian Gas Company
NSGP	North–South Gas Pipeline
pa	per annum
PM	Prime Minister
SCP	South Caucasus Pipeline
SCPX	South Caucasus Pipeline's Expansion
SD1	Shah-Deniz field's 1st stage development
SD2	Shah-Deniz field's 2nd stage development
SGC	Southern Gas Corridor
SOCAR	State Oil Company of Azerbaijani Republic
TANAP	Trans–Anatolian Pipeline
TAP	Trans–Adriatic Pipeline
TPP	thermal power plant
UGS	underground gas storage
UNM	United National Movement
U.S.	United States of America
WEG	World Experience of Georgia
WTO	World Trade Organization

INTRODUCTION

Georgia is geographically located in the South Caucasus region between, on the one hand, the Caspian basin and, on the other, the Black Sea shores. Such a position renders the country a significant transit spot for the transportation of energy resources from the Caspian Sea, specifically for the delivery of Azerbaijani gas and oil to Turkish and world markets. The realization of the Baku–Tbilisi–Ceyhan and Baku–Supsa oil pipelines provided the first visible representation of Georgia's transit importance, and this pattern was later consolidated with the construction of the Baku–Tbilisi–Erzurum (South Caucasus) Gas Pipeline—the first segment of the Southern Gas Corridor, which will deliver Azerbaijan's Shah–Deniz–II gas through Georgia and Turkey to Europe (Greece, Albania, Italy and the Balkans). If the Trans-Caspian Gas Pipeline is ever built, Georgia could become a transit country for the abundant natural gas resources of Turkmenistan and even Kazakhstan.

Albeit rich with the hydro and other mineral resources, Georgia lacks its own tapped oil and gas resources, thus making Georgia strongly dependent on imported oil and gas resources. In this regard, Azerbaijan is a main, and to certain extent Russia a supplementary, player in meeting Georgia's gas needs. Although Russia was previously, until 2007, the main gas supplier for Georgia, Azerbaijan emerged as the key gas supplier after that date. Shifting gas supply from Russia to Azerbaijan enabled Georgia to reduce its dependence on Russian gas and the dominant share of Gazprom in the country's gas imports, as well as providing sustainability of gas supply and consumption. The Georgian policy of import diversification and the Azerbaijani policy of export diversification helped both Azerbaijan and Georgia to strengthen their geopolitical independence as a supplier state and transit state, respectively. The regional energy projects also consolidated rational interdependence and strategic cooperation between Azerbaijan and Georgia.

However, seasonal consumption patterns and subsequent demand imbalance pushed Georgia to explore alternative gas sources, such as Iran or enhanced the gas purchases from Russia. After international sanctions on Iran were partially lifted, numerous news stories went viral on an alleged Georgia–Iran "gas purchase agreement," which was denied by the Georgian side. On the other hand, lack of technical infrastructure and financial opportunities makes it arduous to bring a larger volume of gas through Armenia to meet Georgia's seasonal gas demand.

Talks between Georgia and Gazprom on additional gas supplies to Georgia, along with negotiations on the renewal of the gas transit service for gas flow from Russia to Armenia, caused a public outcry within the country on the political/economic compatibility of the new agreement with the country's energy security. Unlike the previous contract, the new transit agreement ensures a step-by-step monetization of gas transportation service. Our analysis, however, proposes that the Georgian government had a certain rationale, vis-à-vis talks with Russia's Gazprom that led the country to make such a decision, despite the new deal's apparent unfavorable implications.

The ultimate purpose of this research paper is to examine Georgia's gas diversification policy options from the standpoint of economic attractiveness, political likelihood, transportation (infrastructure) connectivity and energy security. The paper encompasses five chapters on Georgia's energy sector including discussion of energy balance, energy demand, gas suppliers, sources, etc.; the role of Azerbaijan in Georgia's energy market and existing pipelines and contracts; Russia's interest in Georgia's gas sector, including recent talks and renewal of the transit agreement, as well as public reactions thereto; and the possibility of Iranian gas exports to Georgia, including the role that Armenia is enthusiastic to play in this regard.

CHAPTER I

1. A Portrait of Georgia's Energy Sector

1.1 Georgia's energy balance and gas demand

Georgia's geographical location positions the country as an expanding transit corridor for oil, natural gas and electric power. However, since the country lacks its own tapped oil/gas resources, Georgia covers most of its gradually increasing gross energy demand from imported energy sources (natural gas and oil), which are therefore subject to progressive growth. Georgia's total primary energy consumption is met by oil and gas, hydro resources, wood and coal. Concerning renewable energy resources, hydro is the dominant resource in the country. Biomass is the second largest energy source produced locally. While there have been some initiatives, yet new renewable resources like solar, wind and geothermal remain strictly underdeveloped. Georgia has seven coal mines, but few of them are active.[1]

While natural gas is the most important source of energy consumed in Georgia, it is also the energy source with the lowest import diversity. Therefore, it is necessary to provide a guaranteed supply of natural gas, which is associated with significant challenges due to the unstable regional political situation, the country's climate-sensitive energy sector, and technologically outdated infrastructure with insufficient capacity. In this regard, the enhancement of the gas transmission infrastructure by using interconnectors with the neighboring systems, effective rehabilitation/reconstruction of internal systems along with connectors among them, and the construction of additional new capacities are effective measures to mitigate possible challenges facing Georgia's energy security.[2]

Due to the country's seasonal demand for heating and the lower level of power generation from run-of-river HPPs, natural gas imports during the winter period are substantial. In Georgia, households represent the largest consumers of energy. Natural gas is the largest resource used and the gas

1 "Energy Strategy of Georgia (2015-2030), 3 Year Action Plan (2015-2018)", White Paper, July 2014, p.4-6. pdf.usaid.gov/pdf_docs/PA00K12R.pdf

2 "Ten-Year Development Plan for Georgian Gas Transmission Infrastructure 2017-2026", Georgian Oil and Gas Corporation, February 2016, p.9, www.gogc.ge/uploads/other/1/1171.pdf

sector is growing rapidly, particularly in rural areas. As many of the villages gain access to natural gas, demand may rise further, at a 5% annual growth rate. The import of gas from Russia at a commercial price is not economically feasible and Georgian gas demand is being supplied by Azerbaijan. To ensure that the rising demand is met in the future, the terms and conditions of the long-term contracts with the supplier need to guarantee gas supply throughout the year and balance the mismatch between seasonal supply and demand, which is otherwise impossible to achieve due to the absence of domestic gas storage.[3]

The natural gas sector of the country is one of the most dynamically developing segments. As the most consumed energy resource in Georgia, natural gas accounts for approximately 40% of the total energy balance, which is mainly provided by imported gas.[4] Georgia's current annual gas consumption ranges between 2.2 and 2.4 billion cubic meters (bcm),[5] but it is subject to change due to the seasonal consumption imbalance between winter (11–12 mcm/d) and summer (3–4 mcm/d). Estimations show that under certain economic growth conditions Georgia's natural gas demand may possibly reach an annual average of approximately 3 to 4 bcm by 2030. During recent years gas demand has increased in all sectors of the economy, including in domestic and commercial gas sectors, and gas consumption continues to grow.[6] In reality, the volume of gas supply is regulated in accordance with the order of priority of clients as set out in the contracts.

Considering that Georgia is significantly dependent on the import of natural gas, an underground gas storage (UGS) is strongly needed to stockpile additional gas to ensure the energy security of the country and to regulate the seasonal imbalance in gas supply and consumption.[7] The problem of gas supply security could possibly be solved thanks to a newly initiated gas storage project of the Georgian Oil and Gas Corporation with 210–280 mcm capacity. Until the construction of the UGS is completed, the seasonal imbalance can be eased by the Azerbaijan's State Oil Company (SOCAR) through its own UGS in Azerbaijan.[8] The UGS facility is needed to stabilize seasonal supply and safeguard Georgia against short-term supply disruptions. Such facilities will help the country to deliver the natural gas requirements of consumers during peak demand periods

3 "Energy Strategy of Georgia (2015-2030)…", *op.cit,* p.13.
4 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.9-10.
5 "Gürcüstan Rusiyadan ucuz qaz ala bilməsi üçün nə etməlidir?", Caspian Barrel, 2015, http://caspianbarrel.org/az/2015/10/gurcustan-rusiyadan-ucuz-qaz-ala-bilm-si-ucun-n-etm-lidir/
6 Liana Jervalidze, "Georgia's Gas Market: Short and Medium Term Challenges", Partnership for Social Initiatives, July 2017, p.3, https://www.naturalgasworld.com/pdfs/Georgias%20Gas%20Market%202.pdf
7 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.22.
8 Jervalidze, "Georgia's Gas Market:…", *op.cit,* p.4.

without exposing consumers to price volatilities.[9] SOCAR has expressed interest in building the Samgora UGS facility in Georgia, as well as in acquire a share in and participating financially in the project,[10] which can help Georgia to reduce its need for additional deliveries from Russia.[11]

1.2 Main actors on Georgia's gas market

The state-owned Georgian Oil and Gas Corporation (GOGC) and Georgian Gas Transportation Company (GGTC) play significant roles in the country's gas market. GOGC is the owner of the country's main gas pipeline system. It supplies the optional and supplemental gas received for transit via the South Caucasus Pipeline (SCP) as well as Russian gas received through "SOCAR Gas Export-Import" for transit by GGTC to electricity generation facilities as well as the regulated segment of the market, household consumers. GOGC also ensures supply of locally produced gas to the competitive segment of the market. According to the agreement signed with Russia's Gazprom, the North–South Gas Pipeline (NSGP) operating company, GGTC, receives the fee for services provided for natural gas transit from Russia to Armenia in-kind on an annual basis.[12] GGTC's core activities include provision of natural gas transportation and transit throughout the territory of Georgia; GGTC also executes gas transit, delivery and transportation through Armenia. One hundred percent of GGTC's shares belong to the Ministry of Energy of Georgia.[13] GOGC's core activities includes the ensuring sustainable development of the wholesale natural gas market; administering and managing the preparation, storage, transportation and sale operations of the state's share of natural gas and oil; rehabilitating, replacing, designing and constructing oil and gas pipelines; building, sustaining and operating necessary infrastructure; participating in and implementing national and international projects; and so on. GOGC aims to cooperate with regional power companies to ensure new, cheap and reliable supply sources and diversify business for the purpose of ensuring sustainable development of the country by attracting investment in energy projects.[14]

SOCAR Energy Georgia Ltd. is a main gas player in Georgia's gas market. The

9 "The Gazprom Deal and Georgian Energy Security. What Should Georgia do Next?", Georgia Today, 2017, http://georgiatoday.ge/news/5735/The-Gazprom-Deal-and-Georgian-Energy-Security.-What-Should-Georgia-do-Next%3F

10 "SOCAR intends to acquire share in Georgian gas storage facilities", Apa.az, February 2016, en.apa.az/xeber_socar_intends_to_acquire_share_in_georgi_238978.html

11 "Georgia Launches Tender For UGS Project", Youroilandgasnews.Com, 2017, http://www.youroilandgasnews.com/georgia+launches+tender+for+ugs+project_143867.html.

12 "Energy Strategy of Georgia (2015-2030)…", *op.cit.*, p.4.

13 "Georgia gas overview", INOGATE Technical Secretariat, March 2016, www.agora.mfa.gr/infofiles/rad1CE2B-STUDY%20GAS%20SECTOR%20GEORGIA-PPT%20NTsakalidis.pdf

14 See official website of GOGC, http://www.gogc.ge/en/about-company

company's activities include retail and bulk selling of fuel in Georgia, import of petroleum and liquefied gas, and construction of oil terminals.[15] SOCAR Georgia Gas Ltd. is the daughter company of SOCAR Energy Georgia. SOCAR Georgia Gas is responsible for: supply and distribution of natural gas; providing the population with natural gas; and construction, rehabilitation and operation of gas distribution networks. In 2008, SOCAR Energy Georgia bought Georgia's natural gas distribution companies located in the individual administrative regions and in 2012 the company bought ITERA–Georgia.[16] In 2013, "ITERA–Georgia" was renamed as "SOCAR Georgia Gas Distributors," JSC, which is responsible for the purchase and sale of natural gas. SOCAR began its activities in the oil and natural gas sector of Georgia in 2006.[17] Though SOCAR is a dominant gas supplier, the Georgian government does not consider the company's presence within the country a huge problem as long as it does not abuse market rules.[18]

1.3 Main sources of gas supply

Around 99 percent of gas consumed in Georgia is imported from three main sources: two from Azerbaijan (SCP and Gazakh pipelines) and the third from Russia (in the form of gas for transit to Armenia via NSGP). Georgia's year-on-year increasing gas consumption makes it necessary to import most of its annual gas demand from Azerbaijan. After Russia's suspension of gas supply that caused a countrywide shortage, leaving many Georgians without sources of heating in winter, the country gradually switched to meeting most of its gas demand from Azerbaijan.[19] Since 2006, Georgia's diversification strategy has been based on the mutually beneficial partnership with Azerbaijan to ensure its energy security, though a relatively small quantity of commercial gas continues to be imported from Russia every year. A tighter energy partnership with Azerbaijan will guarantee Georgia's long-term energy security due to the completion of the expansion of the SCP in 2018.[20] As gas imports from Russia are costlier, the country is expected to switch to import 100 percent of gas from Azerbaijan in the coming years.[21]

In the years 2013 to 2015, the total volume of natural gas exported from Azerbaijan to Georgia was about 90 percent of the total gas consumed.[22] According

15 See official website of SOCAR Energy Georgia Ltd., http://www.socar.ge/page.php?lang=eng&page=00
16 Elnur Ismayil, "Enerji Güvenliğinde Gürcistan'ın Jeopolitik Önemi ve Rusya", Bilgesam, December 2015, www.bilgesam.org/Images/Dokumanlar/0-66-2015121011268.pdf
17 See official website of SOCAR Georgia Gas, http://socargas.ge/ru/history
18 Interview with an official (4) from Ministry of Energy of Georgia.
19 "The Gazprom Deal and Georgian Energy Security", *op.cit.*
20 "The Gazprom Deal and Georgian Energy Security", *op.cit.*
21 Levan Pavlenishvili & Norberto Pignatti, "Georgia's Energy Security in a Nutshell", Georgia Today, 2017, from http://georgiatoday.ge/news/6436/Georgia%E2%80%99s-Energy-Security-in-a-Nutshell
22 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.10.

to the report of the Georgian National Energy and Water Supply Regulatory Commission (GNERC),[23] in 2016, 93.4 percent of Georgia's annual natural gas consumption was met by Azerbaijan (2.113 bcm via the SCP and Gazakh pipelines); Russia held second place with 5.4 percent (122 mcm = 56 mcm in transit fees + 66 mcm commercial gas); Armenia followed with 0.9 percent (19 mcm), which raises the question of the source/route of gas flows from Armenia to Georgia; and local gas industry followed with 0.3 percent (6 mcm) of overall consumption.[24] In 2015, gas imports from Azerbaijan were lower than the 2016 quantities at 83 percent of the total (2.07 bcm – 721 mcm via the SCP and 1.35 bcm via the Gazakh pipeline), while imports from Russia 2015 export were much higher than in 2016 at 12 percent (295 mcm, of which 265 mcm was transit fees).[25]

Table 1: Gas supply in Georgia 2016 (National Energy and Water Supply Regulatory Commission[26])

Natural gas source			Volume (mcm)	Share in total volume (%)
Import	Azerbaijan (SOCAR)		1,321	58.4
	Russia		66	2.9
	Armenia		19	0.9
Local extraction			6	0.3
Transit	From Armenia for transit		56	2.5
	South Caucasus Pipeline (Azerbaijan)	Optional	292	12.9
		Supplemental	500	22.1
Total			2,261	100

1.4 Social and commercial gas sectors

Georgia's gas market comprises *social* (households and power generation) and *commercial* gas sectors. Under Georgian legislation, the social sector is regulated while the commercial sector is completely deregulated, i.e., totally liberalized, allowing private companies freely to find, negotiate and purchase gas available from third-party suppliers on the best conditions and terms. The social gas package includes all gas collected in-kind for transit service and under spe-

23 See annual report of Georgian National Energy and Water Supply Regulatory Commission (GNER, 2017, gnerc.org/files/wliuri%20angariSi/tsliuri%20angariSi%202016_opt.pdf
24 "Georgia Gets 93.4% of its Natural Gas from Azerbaijan", Tabula, 2017, http://www.tabula.ge/en/story/119104-georgia-gets-934-of-its-natural-gas-from-azerbaijan
25 "Georgia Agrees with Gazprom's New Transit Terms", Civil.ge, 2017, http://www.civil.ge/eng/article.php?id=29763
26 See GNERC's annual report, *op.cit.*

cial terms, which Georgia receives as a transit country; this helps to maintain a low gas price for power generation and household consumption in the country. Over the years 2012 to 2017, gas consumption increased significantly in both social and commercial sectors and will continue to increase, according to the forecasts of Georgia's Ministry of Energy.[27]

Consumption in the social gas sector is partially covered by the Shah Deniz Consortium (*optional* and *supplemental* gas: 700 mcm/a); and by a tariff of 10 percent of in-kind gas based on Russian gas transit to Armenia (max. 200 mcm/a). Apart from gas received as a transit fee for Russian gas exports to Armenia, the entire 2.2 bcm/a of gas for social and commercial consumers is supplied by Shah Deniz Consortium and SOCAR under long term contracts.[28] On the consumer side, natural gas for the regulated part of the household sector and power plants is supplied on the basis of regulated tariffs. For other customers, retail and wholesale prices are deregulated and gas is supplied through publicly offered prices and conditions.[29]

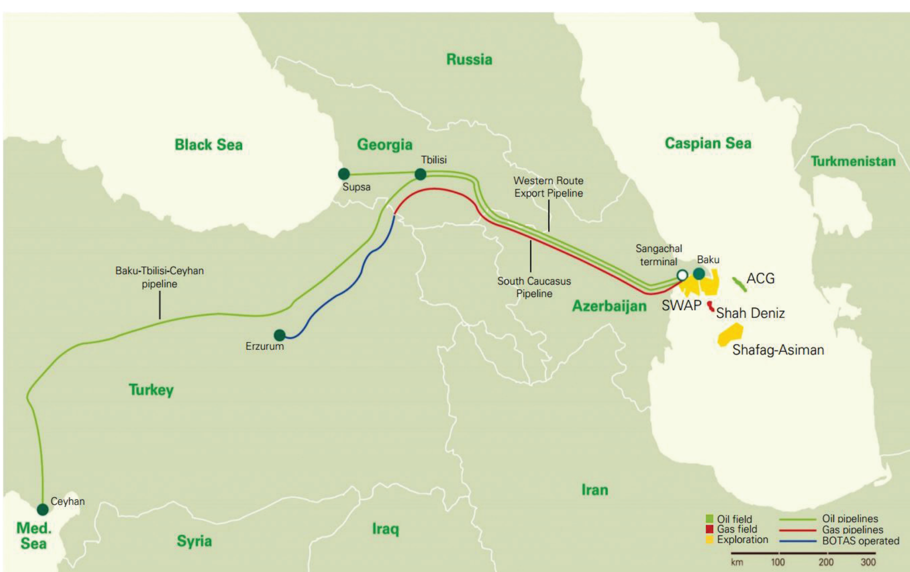
27 Jervalidze, "Georgia's Gas Market…", *op.cit,* p.1-2, 6, 11-13.
28 Liana Jervalidze, "On the Agreement between Gasprom-Export and Georgian Gas Transport Company the New Terms of Russian Gas Transit to Armenia", Partnership for Social Initiatives, January 2017, p.2, https://www.naturalgasworld.com/pdfs/PSI%20Transit%20Terms%20Gasprom%20Export.pdf
29 "Ten-Year Development Plan for Georgian Gas…", *op.cit.,* p.11.

CHAPTER II

2. Azerbaijan As a Key Gas Supplier for Georgia

During the past decade, Azerbaijan has emerged as a reliable and key gas supplier to Georgia by supplying main portion of the country's gas consumption. Azerbaijan's SOCAR is a main player on Georgia's gas market through SOCAR Gas Georgia—a subsidiary of SOCAR-Energy-Georgia. Georgia has been supplied by two Azerbaijani sources in accordance with agreements: (1) with the Shah Deniz international consortium (supplementary gas) and (2) with SCP consortium (optional gas) to receive the Shah-Deniz I gas (SD1) via the SCP; (3) a separate contract to buy SOCAR gas via the Gazakh pipeline.[30]

Map 1: The South Caucasus Pipeline (in red/blue)



Source: BP, conference presentation.

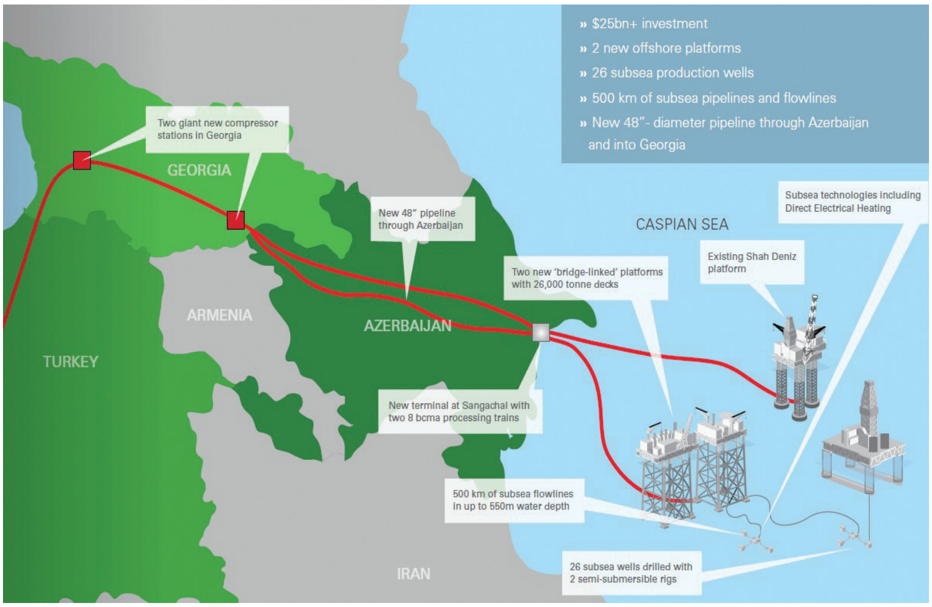
30 Interview with official (2) of GOGC in Georgia.

2.1 Shah-Deniz Consortium and South Caucasus Pipeline (SCP)

SCP is owned by the South Caucasus Pipeline Company Ltd. (SCPC) which is a separate legal entity. SCP is a 692 km pipeline, designed to transport 8 bcm/a of gas from SD1 of Azerbaijan from the Sangachal Terminal to the Georgian and Turkish markets, as well as to the domestic market in Azerbaijan. It is currently supplying 4 mcm/d in winter. The Shah-Deniz consortium supplies Georgia with 800 mcm/a of gas via the SCP (optional and supplementary gas).[31] Under the Host Government Agreement (2002) and Gas Option Contracts between the SCP participants and Georgia, the country has the option to buy up to 5 percent of the gas volume transmitted via SCP as a transit fee.[32] The pipeline is currently being expanded (SCPx) to achieve up to 16 bcm/a of additional capacity for the natural gas coming from SD Phase 2 (SD2) in late 2018/2019. After the expansion, the whole export system on the territory of Azerbaijan and Georgia (SCP and SCPX) will have the capacity to transport contracted export commitments from the both SD1 and SD2 volumes up to 26 bcm/a in total. From the total 16 bcm/a volumes of SD2 up to 10 bcm/a will be delivered to Europe and up to 6 bcm/a will be delivered to Turkey.[33] It is planned that the expansion will be achieved through the construction of a parallel 1,422 millimetre pipeline, with an overall length of 387 km. The cost of this, incorporating associated above-ground installations including block valves, a pigging facility and tie-ins in Azerbaijan and Georgia, along with construction of an additional 59 km pipeline loop and associated above ground installations in Georgia, will be $735 million. The contract for pipeline construction in Azerbaijan and Georgia has been awarded to Saipem/Azfen – a joint venture between Saipem Contracting Netherlands BV and Azfen JV.[34]

31 Interview with official (1) from Ministry of Energy of Georgia.
32 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.10.
33 Gulmira Rzayeva, "The Outlook for Azerbaijani Gas Supplies to Europe: Challenges and Perspectives", Oxford Institute for Energy Studies, Paper: NG 97, ISBN 978-1-78467-028-3, p.23, https://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/06/NG-97.pdf
34 "SCPX construction contract awarded", Bp.Com, 2017, http://www.bp.com/en_az/caspian/press/pressreleases/SCPX-contract-awarded.html.

Map 2: Work on Shah Deniz field's stage 2 project



Source: www.caspianbarrel.org

2.2 Optional and supplemental gas from Shah-Deniz field

Georgia's two contracts with the SCP and Shah Deniz consortiums enable the country to receive *optional* (about 300 mcm/a, dependent on gas volumes transported by SCP) and *supplemental gas* (up to 500 mcm/a under special terms) via the SCP. Thus, Georgia has the opportunity to receive a maximum 800 mcm/a in accordance with these contracts, that expire after 2022/2025.[35]

Georgia receives *optional gas* for transit service of gas delivered from the SD field to Turkey via SCP. Since the SCP is exempted from all expenses and taxes,[36] the Shah Deniz consortium could be liable to pay the transit fee for gas deliveries from the SCP (5 percent of supplied volume) in currency to Georgia's state budget.[37] However, according to the contract with the international consortium, Georgia has the flexibility either to take 5 percent of gas transported via SCP (max. 300 mcm/a) or to collect the transit fee in currency according to international standards (with an option

35 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.9.
36 Interview with official (1) from Ministry of Energy of Georgia.
37 Interview with official (1) of GOGC in Georgia.

to buy gas at preferential prices). Georgia opts for payment in commodity, i.e. in the form of gas. However, the volume of this gas depends on the gas volume transported via the SCP for Turkey that can be a maximum of 6,6 bcm/a in accordance with the contracts signed with international consortium. [38] In addition to the 5 percent transit fee from the SCP, Georgia also has an option, in accordance with a contract with Shah Deniz consortium, to purchase *supplemental gas*[39] (as SD1 gas) to a maximum of 500 mcm/a from SCP under special terms—approximately \$55/1000 m^3, with an annual escalator of \$1.5/1000 m^3 from 2008. The agreement for supplemental gas expires in 2025.[40]

Given the fact that the SD1 field started producing in late 2006 and reached its plateau level in 2010, the field's geological tail-off period is expected to begin in 2025–2027. During the tail-off period, production levels may decrease by around 2 bcm/a or more, depending on well productivity. There may not be enough gas to renew the SD1 contract for a longer term. The 15-year sales/purchase contract signed between the SD consortium and Turkey's BOTAŞ to import 6 bcm/a of SD2 gas could simply substitute the SD1 6,6 bcm/a, rather than being an additional volume. Alternatively, the remaining volume from SD1 could be added on top of the contracted 6 bcm/a of SD2 gas. Realization of this scenario will depend on if both seller and buyer would be interested financially and legally in the exchange of SD1 volumes under the SD2 contract.[41]

After completion of Trans-Anatolian Pipeline, Trans-Adriatic Pipeline and SCP's expansion that will result in the transportation of 16 bcm/a of Azerbaijani gas from SD2 via the SCP in addition to the current 6 bcm/a from SD1, Georgia's share as a transit fee will also increase. Thus, Georgia can receive additional 800 mcm/a of gas (5 percent of 16 bcm/a) as a transit fee.[42] Azerbaijan's gas production will significantly increase from late 2018 with the SD2 comes on stream. This will add some 16 bcm/a to the 9 bcm/a produced from the SD1, thus increasing overall gas production from the whole SD field to 26,6 bcm/a.[43] If supply from the SD field is increased, then Georgia can receive further free gas as a transit fee, plus 500 mcm/a at a preferential price

38 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.7.
39 Interview with expert (1) in Georgia.
40 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.6-9.
41 Ole Gunnar Austvik and Gulmira Rzayeva, "Turkey in the Geopolitics of Natural Gas", Mossavar-Rahmani Center for Business & Government, Harvard Kennedy School, September 2016, p.9, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/66_final.pdf
42 Nino Patsuria, "Shah Deniz prospects", Georgian Journal, February 2014, www.georgianjournal.ge/business/26241-shah-deniz-prospects.html
43 Rzayeva, "The Outlook for Azerbaijani Gas Supplies to Europe…", *op.cit.* p.19.

and and additional 500 mcm/a social gas (in total, 2.5 bcm/a). Georgia would then be fully supplied by Azerbaijani gas.[44]

The cost of gas from Azerbaijan to Georgia varies. SOCAR provides cheap social gas prices, however its commercial gas is relatively expensive for Georgia.[45] As a transit country for Azerbaijani gas, Georgia has a right to buy 750–800 mcm of gas at preferential prices (500 mcm/a for approximately $64/1000 m^3 and 250–300 mcm/a for $55/1000 m^3). The remaining gas ("commercial" gas) is purchased at market price, currently around $237/1000 m^3.[46] Azerbaijani social gas is also supplied to Georgia via SOCAR at reduced prices: approximately $120/1000 m^3 for consumers and $143/1000 m^3 for power generation, which is lower than Gazprom's price for Armenia (approximately $150/1000 m^3).[47]

2.3 SOCAR's gas supply via "Gazakh" pipeline

Under the MoU for supply of natural gas between Georgia and SOCAR and the relevant gas purchase and sale contracts, Georgia can meet the entire demand of social consumers from Azerbaijani natural gas supplied by SOCAR through its subsidiary SOCAR Gas Georgia, in addition to optional and supplementary gas provided via SCP. Moreover, SOCAR currently meets the demands of Georgia's industrial and commercial sectors at market prices.[48] Most of Azerbaijan's gas exports to Georgia flow through Gazimagomed-Gazakh-Gardabani-Saguramo (GGGS) —a.k.a "Gazakh" gas pipeline—with maximum load capacity of 6.6 mcm/d (about 2,4 bcm/a). The load limitation on the "Gazakh" pipeline makes it difficult to supply extra gas, greater than the pipeline's actual capacity, in the winter months when consumption reaches peak level in Georgia. In 2016 Georgia signed a new agreement with SOCAR for the supply of an additional 500 mcm/a at a reduced price.[49] Moreover, with maintenance work on the "Gazakh" pipeline that will increase its throughput capacity to 10 mcm/d, SOCAR will be able to supply Georgia with an additional 3–4 mcm/d of gas (maximum 1.44 bcm/a) via this pipeline.[50]

44 "SOCAR не учитывает ряд моментов в энергетике Грузии - эксперт", Business Gruziya, October 2015, bizzone.info/experts/2015/1445654240.php
45 Interview with Expert (1) in Georgia.
46 "Deal of Georgia with Gazprom is beneficial to both parties", The Newspapers, 2017, https://the-newspapers.com/2017/01/13/deal-of-georgia-with-gazprom-is-beneficial-to-both-parties
47 «Georgia quits buying natural gas from Gazprom in 2017», JAMnews, 2017, https://jam-news.net/?p=32282
48 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.11.
49 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.9-10.
50 "Cooperation in hydrocarbon trade, exports in Caspian region in focus of SOCAR forum", AzerNews.az, 2017, https://www.azernews.az/oil_and_gas/112066.html

Map 3: Pipeline system in Georgia

Source: www.georgiatoday.ge

CHAPTER III

3. Russia's Interest in Georgia's Gas Market

3.1 Russia's previous market share in Georgia

During 1996 to 2003, Russia's ITERA was a main gas supplier for Georgia and owned the natural gas distribution companies in the country's industrial centers, and in addition it wanted to control the main gas pipelines within country. As of 2002, the administration of the then president, the late Eduard Shevardnadze, sought to alienate ITERA from the Georgian gas sector. In 2002, Russia's Gazprom took control of the natural gas sector from ITERA and signed a 25-year strategic cooperation agreement with the Georgian government in order to control the main gas pipelines in Georgia. After 2003, once ITERA was sidelined from the Georgian energy market, Gazprom became a monopoly natural gas supplier. Then Georgian opposition did not welcome this due to its implications for Shah-Deniz project and Russian dominance in the Georgian energy market.[51]

Before 2008, the Russian gas price for Georgia was approx. $230/1000m^3$, which was considered the most expensive price among the CIS countries.[52] In 2006, the gas price was increased from $63 to $110/1000 m^3$, and subsequently in 2007 from $110 to $230/1000 m^3$.[53] At that time, Russia was buying Turkmen gas at approx. $100/1000 m^3$ and selling it to Georgia at $230/1000 m^3$, while Belarus was paying $164/1000 m^3$.[54] Therefore, Georgia initially approached Kazakhstan's KazTransGaz (a subsidiary of KazMunaiGaz) for cheaper gas supply. However, Gazprom was not eager to give up control of Georgia's gas pipelines and market to an alternative supplier. As of 2006, the Georgian government liberalized the gas market and allowed other energy companies within the country to negotiate the purchase of Russian gas with Russian companies, but they failed in purchasing cheaper gas.[55]

51 Ismayil, *op.cit.*

52 Marianna Grigoryan, "Georgia Shows Interest in Iran-Armenia Gas Pipeline", Eurasianet.org, April 2007, www.eurasianet.org/departments/business/articles/eav041207.shtml

53 Liana Jervalidze, "Georgia's State Energy Policy in the Natural Gas Sector", Transparency International Georgia, February 2008, www.transparency.ge/sites/default/files/Georgia's%20Policy%20in%20the%20Natural%20Gas%20Sector%20eng.pdf

54 «Нона Михелидзе - Грузия из Европы выглядит так: государство, у которого вообще нет ответа на ряд злободневных вопросов или есть ошибочное видение развития», Interpressnews.ge, October 2015, www.interpressnews.ge/ru/2012-11-26-13-38-46/76116-2015-10-14-09-55-53.html

55 Ismayil, *op.cit.*

In 2007, the Georgian government therefore requested the assistance of Azerbaijan to provide an alternative gas supply to Georgia. Azerbaijan's gas supplies to Georgia enabled the country to significantly decrease its gas dependence on Russia. Nevertheless, until recently Gazprom, through its subsidiary Gazprom Export, was still supplying gas to Georgia as a part of a transit fee for Russian gas exported to Armenia via the North–South Gas Pipeline (NSGP), which passes through Georgian territory. The 221 km-long NSGP system comprises the parallel North Caucasus–South Caucasus and Vladikavkaz–Tbilisi/Kazakh–Saguramo gas pipelines. However, Russia made the unilateral decision to isolate the latter pipeline within its territory (it was not repaired following a 2006 terrorist attack) and currently NSGP is operational mainly for a transit function.[56] NSGP's actual load capacity is 6 bcm/a without load or supply limitations. To date, Georgia has been receiving 10 percent of Russian gas transit to Armenia (around 200 mcm/a, depending on Armenia's gas demand), which is included in the social gas package of Georgia's gas balance, and GGTC and Gazprom Export have been renewing the terms of transit agreement annually. Due to contractual limitations on the SCP and capacity limitations on "Gazakh" gas pipeline, Georgia has been using this 10 percent of transit gas to balance winter peak demand.[57]

3.2 Georgia–Gazprom gas talks

Starting from 2015, Georgia and Gazprom had been discussing the purchase of additional gas from Russia for Georgia's commercial enterprises and the augmentation of Russian gas export to Armenia via Georgia. The additional gas was required to fill the consumption gap due to increasing demand from commercial entities in Georgia.[58] According to the former energy minister of Georgia, Kakha Kaladze, the country planned to buy additional gas from Gazprom because it was then that they recognized the technical capacity limitation with "Gazakh" pipeline to meet the extra gas consumption of the country during peak demand in the winter period. [59]

SOCAR Energy Georgia has denied technical interruptions in gas supply,[60] stating that Azerbaijan can completely meet Georgia's gas needs.[61] Moreover, the additional gas demand can be covered by increasing gas supply from the current 6–6.5 to 7 mcm/d via "Gazakh" pipeline and from SD field via SCP.[62] Currently, the Shah

56 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.52.
57 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.6-9.
58 "Georgian Energy Minister Speaks of Need to Buy Russian Gas", Civil.ge, October 2015, www.civil.ge/eng/article.php?id=28674
59 "Head OF SOCAR Holds Talks In Tbilisi", Civil.Ge, 2016, http://www.civil.ge/eng/article.php?id=28909.
60 "No problem in gas supply to Georgia - SOCAR Energy Georgia", Apa.az, January 2016, en.apa.az/xeber_socar_says_no_problem_in_gas_supply_to_g_237656.html
61 «SOCAR Georgia: AP обеспечивает почти все потребности Грузии в газе», Sputnik.az, 2015, ru.sputnik.az/economy/20151022/402452835.html
62 "Head Of SOCAR Holds Talks In Tbilisi", *op.cit.*

Deniz consortium supplies Georgia with gas without any interruption.[63] Gas supply outages might occur due to unexpected technological setbacks occurring in Azerbaijan's gas fields or necessary maintenance work, such as tests on pipelines or metering units.[64] According to the Georgian Ministry of Energy, shortage of gas supply from Azerbaijan does not imply shortage of reserves or production, but is due to gas supply limitations associated with seasonal fluctuations in the domestic gas consumption of Georgia. The technical limitations of Gazakh pipeline and suspension of works on the SD field, which typically suspend gas supply via the SCP in the short term, are reasonable restrictions.[65] Since Azerbaijan had increased the gasification of its regions too,[66] Georgia's additional needs have been left unmet. The gas deficit in Georgia is experienced mostly during winter, while it is sufficient in summer, reflecting fluctuations in domestic gas consumption in both countries.[67]

Another reason behind Georgia's attempts to buy additional Russian gas could be the commissioning of a newly built thermal power plant (TPP) in Gardabani region with a demand for 250–300 mcm/a of gas.[68] The supply of additional volume of gas for this power plant required holding new negotiations, as it was outside the framework of current agreements between Georgia and Azerbaijan. Nevertheless, Georgia did not officially request revision of the gas purchase agreement or gas prices.[69] When the price of Azerbaijani gas for commercial consumers was increased by 30 percent in 2015 (to \$318/1000 m^3), Georgia decided to negotiate with Gazprom after the country received a "competitive offer."[70] It was expected that with more gas coming from Russia to Armenia, Georgia's gas share in the form of transit fee could be increased as well.[71] However, following the construction of new gas storage in Georgia, the country is planning to reduce its dependence on Russian gas to zero.[72]

Meanwhile, Georgia's opposition party the United National Movement (UNM) called for the National Security Council to convene to discuss the compatibility of importing Russian gas with the country's national security, notwithstanding the Georgian MoE called the talks with Gazprom purely commercial and harmless for the country's energy security. According to the UNM, Russia could use the gas sup-

63 Interview with official (1) of GOGC in Georgia.
64 "Ten-Year Development Plan for Georgian Gas…", *op.cit,* p.20.
65 Interview with official (1) from Ministry of Energy of Georgia.
66 "Gürcüstan Rusiyadan ucuz qaz ala bilməsi üçün nə etməlidir?", *op.cit.*
67 Interview with official (1) of GOGC in Georgia.
68 "Azerbaijan has gas for Georgia, but Gasprom to enter this market too", Caspian Barrel, November 2015, caspianbarrel.org/?p=36024
69 «Грузия не обращалась к Азербайджану в отношении изменения соглашения по закупкам», Gruziya Onlayn, November 2015, www.apsny.ge/2015/eco/1446744652.php
70 Giorgi Lomsadze, "Iran Joins Georgia's Caucasian Gas Circle", EurasiaNet.org, 2016, http://www.eurasianet.org/node/77436
71 "Gas Maps: 'Blue' Fuel Shaping Policies In South Caucasus", Armenianow.Com, 2017, https://www.armenianow.com/commentary/analysis/67136/armenia_gas_region_map_iran_georgia_russia.
72 «Tbilisi Rejects Russian Gas – The International Massmedia Agency», Intmassmedia.Com, 2017, https://intmassmedia.com/2017/04/17/tbilisi-rejects-russian-gas/.

ply as political leverage over Georgia.[73] In this regard, the representatives of the UNM and other opposition politicians, public activists and NGOs held a rally in Tbilisi protesting Gazprom. [74] However, Georgia's MoE stated that the country had previously been buying additional Russian gas from Gazprom on top of the transit fee, even when the UNM was in power. Indeed, purchase of additional (apart from transit fee) gas had conducted even during the administration of Mikheil Saakashvili.[75] In 2014, Georgia received 267.7 mcm of Russian gas, of which 206.1 mcm was a transit fee and 61.6 mcm was additional purchases (see Table 2).[76] Purchase of commercial gas from Gazprom does not mean halting cooperation with Azerbaijan, stated Georgia's former energy minister, Kakha Kaladze.[77]

Table 2: Georgia's gas imports p/a and per supply 2003–2014

Year	Gas Consumption by Georgia (m^3)	Transit fee (for Russian gas to Armenia)	From Russia on top of transit fee	South Caucasus Pipeline (Shah Deniz)	Azerbaijan (Gazakh pipe.)	Iran	Other
2015	2,478,000,000	200,000,000	75,000,000	712,000,000	1,483,000,000	0	8,000,000
2014	2,177,036,000	206,166,000	61,607,000	686,022,000	1,211,552,000	0	11,689,000
2013	1,912,530,000	195,633,000	0	677,353,000	1,037,737,000	0	1,807,000
2012	1,969,199,000	196,720,000	32,249,000	717,416,000	922,986,000	0	29,829,000
2011	1,782,729,000	160,906,000	31,233,000	737,803,000	775,762,000	0	77,025,000
2010	1,121,140,000	144,014,000	43,665,000	525,873,000	338,570,000	0	69,019,000
2009	1,188,822,000	147,316,000	117,426,000	404,654,000	510,622,000	0	7,804,000
2008	1,471,218,000	225,437,000	508,931,000	265,139,000	471,711,000	0	
2007	1,700,020,000	205,436,000	975,268,000	250,411,000	268,905,000	0	
2006	1,806,417,000	171,564,000	1,610,396,000	0	19,502,000	4,955,000	
2005	1,331,575,000	168,503,000	1,163,072,000	0	0	0	
2004	1,112,910,000	133,257,000	979,653,000	0	0	0	
2003	878,791,000	120,095,000	758,696,000	0	0	0	

Source: MoE of Georgia[78]

It was alleged that Georgia's former Prime Minister (PM) Bidzina Ivanishvili could be behind the gas negotiations with Russia[79] because of his business ties

73 «ЕНД требует созыва заседания Совбеза в связи с переговорами властей с «Газпромом»», Gruziya Onlyan, October 2015, www.apsny.ge/2015/pol/1444517877.php
74 «В Тбилиси сторонники Саакашвили выступили против сотрудничества с «Газпромом»», Interfax, October 2015, www.interfax.ru/world/474024
75 Interview with Expert (1) in Georgia.
76 "Georgian Energy Minister speaks of need to buy Russian Gas", *op.cit.*
77 Giorgi Menabde, "Gazprom Tries to Seduce Georgia", The Jamestown Foundation, November 2015, https://jamestown.org/program/gazprom-tries-to-seduce-georgia/#.Vu-3Y_mLTIX
78 "Georgia Says To Receive Additional Gas From Azerbaijan, No Need For More Gazprom Gas", Civil.Ge, 2016, http://www.civil.ge/eng/article.php?id=29021
79 "Ivanishvili Speaks of Need to 'Diversify' Gas Supplies", Civil.ge, October 2015, civil.ge/eng/article.php?id=28705

to Russia and as he was also a founder of Georgian Dream (GD) party. The internal divergence between the ruling government itself and political coalitions is also a noteworthy factor in this regard. Perhaps, with foreign policy evolving at that time, Georgia also wanted to mitigate Russia's tough stance over the country's pipeline network by purchasing quite a small volume of gas from Gazprom, or merely to get gas at a competitive price from a new supplier.[80] According to Tornike Sharashenidze, a professor from GIPA, "Replacing Azerbaijani gas with Russian gas is an extremely dangerous. Georgia simply cannot afford to alienate Azerbaijan. It is thanks to its strategic partnership with Baku that Tbilisi not only reduced its dependence on Gazprom, but also became part of important energy and trade corridors."[81]

3.3 Problems resolved with Azerbaijan

The energy talks between Georgia and Russia made headlines in both Azerbaijani and Georgian media. This was followed by an official visit of former Georgian PM Irakli Garibashvili to Azerbaijan in October 2015, and the visit of Azerbaijani President Ilham Aliyev to Georgia in early November 2015,[82] where he stated that Azerbaijan has enough gas resources to meet not only domestic supply, but also that of Europe.[83] During his Tbilisi visit, President Aliyev reiterated the strategic significance of relations in a Joint Declaration with the Georgian president, in which they committed to high-level dialogue on energy issues and the SGC, the gasification of Georgia's regions and securing a reliable gas supply for Georgia.[84] A few days before President Aliyev's visit, President of Armenia, Serj Sargsyan, had paid a visit to Georgia to discuss the transit of Iranian gas to Georgia through Armenia and of Russian gas via Georgia to Armenia.[85]

Following the Georgian MoE's statement that Russia offered a lower gas price than Azerbaijan,[86] SOCAR entered into new negotiations with the Georgian government in January 2016 to discuss the technical sides of gas supply.[87] Afterwards,

80 "Georgia-Russia Energy Negotiations Cause Controversy", Stratfor, November 2015, https://www.stratfor.com/sample/image/georgia-russia-energy-negotiations-cause-controversy

81 Tornike Sharashenidze, "Georgia's Gazprom mystery", European Council on Foreign Relations, December 2015, www.ecfr.eu/article/commentary_Georgias_Gazprom_mystery5061

82 «Зачем Алиев посетит Грузию», GeorgiaNews.org, October 2015, georgia-news.org/politika/629-zachem-aliev-posetit-gruziyu.html

83 «О чем говорили Алиев и руководство Грузии?», Haqqin.az, November 2015, haqqin.az/news/56497

84 "Joint Declaration of Presidents of Azerbaijan and Georgia", Civil.ge, November 2015, www.civil.ge/eng/article.php?id=28747

85 "Working Visit of President Serzh Sargsyan to Georgia", The President Of The Republic Of Armenia [The Official Site], President.Am, October 2015, http://www.president.am/en/foreign-visits/item/2015/10/30/President-Serzh-Sargsyan-working-visit-to-Georgia/.

86 "SOCAR and Georgian government start negotiations in Tbilisi", Apa.az, January 2016, en.apa.az/xeber_socar_and_georgian_government_start_nego_237726.html

87 "U.S. Ambassador on Georgia's Talks with Gazprom", Civil.ge, January 2016, civil.ge/eng/article.php?id=28920

SOCAR and the Georgian government agreed on the augmentation of Azerbaijan's gas supply to Georgia from 6 to 7 mcm/d.[88] Under the new gas agreement signed between SOCAR and Georgia, Azerbaijan will have no problem in supplying Georgia with gas up to 2030. Georgia's former energy minister Kaladze confirmed that SOCAR was able successfully to resolve technical problems with planned import of additional gas volumes from Azerbaijan to Georgia from SD field, thus there is no need for additional volumes of gas from Russia.[89]

The gas price will be calculated under an agreed formula in accordance with the movement of oil prices on the world market. SOCAR will reduce prices by approximately \$35–40 for gas stations in Georgia.[90] Moreover, Georgia will receive an additional 500 mcm/a gas, with discounts for social[91] and commercial gas (reduced from \$318 to approximately \$278–\$283/1000m^3)[92] from Azerbaijan in accordance with the new gas agreement. SOCAR's president Rovnag Abdullayev said that, with an additional purchase of 500–700 mcm/a of gas from the Shah Deniz Consortium, gas delivery from the SD1 field will be increased from 800 mcm/a up to 1.5 bcm/a via the SCP and up to 1.5 bcm/a from SOCAR via "Gazakh" pipeline.[93] Georgia and Azerbaijan have agreed to redistribute supplies so that Georgia gets less Azerbaijani gas in summer and more in winter, when consumption peaks.[94]

Similar cases of gas negotiations were observed during the construction of the Baku–Tbilisi–Ceyhan oil pipeline, delaying product completion by two years. Supposedly, Georgia wanted to reconsider the commercial dividends of BTC. Therefore, late/then President Haydar Aliyev made a compromise with Georgia, granting all transit revenues coming from oil transportation through the Azerbaijani pipeline section to Georgia.[95] In 2012, then Minister of Economics George Kvirikashvili declared that Georgia could revise the pricing in its energy contracts with Azerbaijan's SOCAR.[96] Azerbaijan, in turn, welcomed the concerns of its strategic ally Georgia with great understanding and friendship.

88 "SOCAR increases gas transportation to Georgia", Apa.az, January 2016, en.apa.az/xeber_socar_increases_gas_transportation_to_ge_237769.html
89 "Georgia Says To Receive Additional Gas From Azerbaijan", *op.cit.*
90 "SOCAR: Azerbaijan will have no problem in supplying Georgia with natural gas till 2030", Caspian Barrel, March 2016, caspianbarrel.org/?p=40373
91 "Georgia to get additional 500 million cubic meters of gas from Azerbaijan", Interpressnews, March 2016, www.interpressnews.ge/en/society/76498-georgia-to-get-additional-500-million-cubic-meters-of-gas-from-azerbaijan.html?ar=A
92 "Georgia: Azerbaijan Wins Gas Deal Over Russia, Iran", Eurasianet.org, March 2016, www.eurasianet.org/node/77661
93 «Азербайджан на полмиллиарда кубометров в год увеличит экспорт газа в Грузию», Trend, February 2016, www.trend.az/business/energy/2500669.html
94 Lomsadze, "Iran Joins Georgia's Caucasian Gas Circle", *op.cit.*
95 «Ильхам Алиев Едет В Тбилиси Расставить Все Точки Над I», Haqqin.Az, 2015, https://haqqin.az/news/56387.
96 "Georgian Dream About Cheap Gas", Georgiatimes.Info, 2017, http://www.georgiatimes.info/en/interview/82776.html.

CHAPTER IV

4. Monetization of Russian gas transit to Armenia

4.1 Gazprom–Georgia talks on transit fee

The gas transit agreement between Georgia and Russia was implemented in accordance with short-term transit contracts, which are discussed, revised, agreed upon and signed annually. The contracts did not include "use or pay" or "take or pay" clauses.[97] However, beginning in 2007, Russia's Gazprom demanded that with the extension of the transit agreement the payment for gas transit through Georgia be carried out not in the form of gas, but in cash, in compliance with international standards. The Russian side stated that because of increased consumption, the entire capacity of the pipeline going through the territory of Georgia was needed to supply Armenia, and there simply was not enough natural gas to pay Georgia in kind. [98] Georgia initially rejected this condition, because the country was interested in preserving the existing transit terms.[99] The terms of the transit agreement between Gazprom and Georgia concerning transit of natural gas to Armenia through Georgia expired on 31 December 2016[100] and the sides conducted a new round of talks on the basis of a 2003 agreement that is renewed annually, for extension of transit agreement. In the absence of a transit contract, Georgia continued receiving in-kind gas from the NSGP to meet peak winter demand. However, Gazprom could subject Georgia to a lawsuit. Georgia could, by making concessions, preserve the previous terms of contract. However, concession from Georgia would mean losing leverage on Gazprom and opening the gas market to the company, which was politically unacceptable and commercially questionable. Therefore, it was of utmost importance to ink a new agreement with Gazprom.[101]

After lengthy negotiations, on January 10, 2017, the Georgian government and

97 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.11.
98 «Грузия повелась на российский блеф - P2 выяснила некоторые детали соглашения с Газпромом», Gruziya Online, 2017, http://www.apsny.ge/2017/eco/1485199255.php
99 "Georgia even with payment for transit of Russia gas to Armenia wants to keep benefits", Interfax.com, 2017, http://www.interfax.com/newsinf.asp?id=726355
100 "Georgia Reaches New Agreement With Russian Gazprom: Monetary Compensation In Return For Transit Rights", 2017, Agenda.Ge, http://agenda.ge/news/73028/eng.
101 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.11.

Russia's Gazprom reached a two-year (2017–2018) agreement on the terms of gas transit, envisaging a shift from "payment in gas" to "payment in money" for gas transit to Armenia from Russia.[102] The new agreement was signed in April 2017 between Gazprom Export and GOGC. Unlike the previous agreement, according to which Georgia was receiving 10 percent of Russian gas transported to Armenia, the new agreement will provide for the gradual monetization of gas transit service in conformity with international standards. In accordance with the agreement reached, in the first year of the contract (2017), Georgia will partially maintain the commodity payment scheme,[103] receiving half of the previous 10 percent of Russian in-kind gas for the first 1 bcm (out of 2.2 bcm/a supplied to Armenia), with Gazprom Export covering the transportation service for the remaining volume of 1.2 bcm in cash.[104] In 2018, the entire gas transport service will be shifted to monetization for the 2–2.2 bcm/a Russian gas transiting through Georgian territory to Armenia.[105] Moreover, Georgia will have the option of purchasing additional natural gas on flexible terms at the price of \$185/1000 m^3 (\$30 less than previous \$215).[106]

Former energy minister Kaladze said that the Georgian government made "an optimal" decision on agreeing to Gazprom's proposal on the terms of gas transit. He also stressed that it will not increase Georgia's dependence on Russian gas, but only the form of payment will be changed, in accordance with international practice. Moreover, the transit fee that Georgia will receive will be one of the highest among European countries and with this money the country can purchase additional natural gas at a discounted price (\$185 instead of \$215/1000 m^3) to meet seasonal shortage, the minister underlined, although without elaborating the amount of the transit payment.[107]

Although Elena Burmistrova, director general of Gazprom Export, called the agreement "mutually beneficial" to bring a "guaranteed income flow from gas transit services," the UNM described the government's acceptance of Gazprom's terms as "a very dangerous decision" for the country's security.[108] Later, Kaladze admitted that Russia itself wanted to stop giving Georgia the natural gas as a transit fee, and receive payment in cash. When Georgia expressed its disagreement on Gazprom's requirements for "the monetization" of payment for gas

102 Interview with official (2) of GOGC in Georgia.
103 Interview with expert (1) in Georgia.
104 Jervalidze, "On the Agreement between Gasprom.. and Georgia…", *op.cit*, p.1;
105 "Gazprom Export and Georgian party have agreed on transit terms", Gazpromexport.com, 2017, http://www.gazpromexport.com/en/presscenter/news/1921/
106 "Azerbaijan To Provide Georgia With Alternative To Russian Gas In 2017", RadioFreeEurope/RadioLiberty, 2017, https://www.rferl.org/a/caucasus-report-georgia-gas-agreement-azerbaijan-gazprom/28439726.html
107 "Georgia agrees to receive gas transit fee by cash instead of gas", Naturalgasworld.com, 2017, https://www.naturalgasworld.com/georgia-agrees-with-gazprom-transit-proposals-35361
108 "Georgia Agrees with Gazprom's New Transit Terms", *op.cit.*

transit instead of the previously applied 10% of total volume of gas, Gazprom presented Georgia with a tough ultimatum that the company would suspend gas transit through Georgia and supply Armenia through Iran instead.[109] Georgia expects to receive the profits according to an objectively-set price equivalent to the amount of natural gas received from the transit fee.[110]

4.2 Opposition to the new transit deal

Some experts and political groups, concerned with the country's unwarranted concession to Moscow, criticized the ruling government because of the change in the form of the transit payment under Russian pressure.[111] They also argued that the Georgian government had failed to use its very strong position in negotiations with Gazprom, as the latter has no option to supply Armenia other than to use Georgia's gas network. As they pointed out, the previous government managed to preserve the transit contracts on profitable terms in even in 2006 and 2008, when Russia–Georgia relations were experiencing their worst years.[112]

Georgia's opposition party, the UNM, disapproved of the new deal, alleging that the government is under the Russian influence, because Russia's target is the country's gas distribution system.[113] They called on the authorities to present the agreement's details to parliament with a claim that it is harmful for the country's political-economic interests. It is believed that the money will allow Georgia to buy a lower gas volume than previously received.[114] Previous gas negotiations with Gazprom had given rise to public demonstrations. Nevertheless, Georgia's MoE vowed that there is no danger of becoming more dependent on Russian gas[115] and has refused to disclose the details of the agreement on the basis that it is a commercial secret and it was not made public even during the Saakashvili or Shevardnadze governments.[116] With the same motivation, Georgian President Georgi Margvelashvili called on the par-

109 Заур Расулзаде, "Российский газ в Армению через Иран", Haqqin.az, January 2016, haqqin.az/news/61935; Георгий Кобаладзе, «Гол Газпрому», Radio Svoboda, January 2016, www.svoboda.org/content/article/27509471.html

110 "Georgia and Russia negotiating gas transit fee to Armenia", Arka.am, 2017, http://arka.am/en/news/business/georgia_and_russia_negotiating_gas_transit_fee_to_armenia/

111 «Сделка Грузии с Газпромом выгодна обеим сторонам», Vzglad.ru, 2017, https://vz.ru/economy/2017/1/12/853000.html

112 Jervalidze, "On the Agreement between Gasprom.. and Georgia…", *op.cit.,* p.2.

113 «Georgia & Gazprom Make New Deal», Georgia Today, 2017, http://georgiatoday.ge/news/5579/Georgia-%26-Gazprom-Make-New-Deal.

114 "President, Political Parties, Csos Slam New Transit Deal With Gazprom", Civil.Ge, 2017, http://www.civil.ge/eng/article.php?id=29781.

115 "Gazprom to switch to monetary transit fee for using Georgia pipeline", Democracy & Freedom Watch, 2017, http://dfwatch.net/gazprom-to-switch-to-monetary-transit-fee-for-using-georgia-pipeline-47277

116 «Каладзе: Соглашение с «Газпромом» – коммерческая тайна», Gruziya Online, 2017, www.apsny.ge/2017/eco/1484802561.php

liament to take effective measures for oversight of the agreement and propose a plan for how to overcome and minimize the expected economic and political risks and threats from the deal to the country's energy sector.[117] However, the government did not agree with the president and considered the agreement maximally rational.[118]

Georgian Civil Society Organizations (CSOs) also denounced the new deal in an emotional way, saying that the new transit terms with Gazprom were unfavorable and could jeopardize the country's long-term energy and national security. They also called on the government to disclose the contract's terms, since its preparation was conducted non-transparently without the involvement of Georgian experts, the academic community or CSOs.[119] They questioned the rapidly changing position of the government (as the Georgian Dreams had always been against monetization) and the government approval for seasonal gas shortages being met by Russia. The NGOs also inquired whether the transit fee is in line with the price calculated under the requirements of the European Energy Community (EEC)[120] and whether Georgia submitted due to Russian coercion, especially as Georgia had a strong position as a transit country through which to gain some concessions from Moscow. Another question was what financial settlement and what percentage of transported natural gas Georgia will receive after switching to monetary payments. CSOs are also concerned about the political implications of the deal due to Russia's record as an unreliable energy supplier in Europe using energy resources to blackmail countries to secure Moscow's political goals. Therefore, the deal is viewed by them as politically irrational and self-defeating for Tbilisi and reflective of Gazprom's desire to entrench and consolidate its previous energy market share in Georgia.[121]

117 «Президенту Грузии Не Нравится Договор С «Газпромом»», 2017, Sputnik-Georgia.Ru, https://sputnik-georgia.ru/politics/20170117/234562236/Prezidentu-Gruzii-ne-nravitsja-dogovor-s-Gazpromom.html.

118 «Georgia Would Reduce Dependence On Russian Gas To Zero Thanks To Azerbaijan - Minister», En.Apa.Az, 2017, http://en.apa.az/azerbaijan_energy_and_industry/georgia-would-reduce-dependence-on-russian-gas-to-zero-thanks-to-azerbaijan-minister.html.

119 Statement of the Eastern Partnership Civil Society Forum Georgian National Platform on the "Results of Negotiations between the Ministry of Energy of Georgia and Russian State-owned Company Gazprom Export", Eapnationalplatform.ge, 2017, http://www.eapnationalplatform.ge/admin/editor/uploads/files/gancxadebebi/statement-gazprom.pdf

120 «Ngos And Opposition Call On Energy Ministry To Disclose Details Of New Deal With Gazprom», Georgia Today, 2017, http://georgiatoday.ge/news/5607/NGOs-and-Opposition-Call-on-Energy-Ministry-to-Disclose-Details-of-New-Deal-with-Gazprom; «Georgian Ngos Urge Release Of Documents On Terms Of Russian Gas Transit To Armenia Via Georgia», Panorama.Am, 2017, https://www.panorama.am/en/news/2017/01/18/Georgian-NGO-urge-release-documents-Russian-gas-transit-Armenia/1710989; «NGO Claims Energy Ministry Violated The Law», Georgia Today, 2017, http://georgiatoday.ge/news/5689/NGO-Claims-Energy-Ministry-Violated-the-Law; "President, Political Parties, Csos Slam New Transit Deal With Gazprom", *op.cit.*

121 Vasili Rukhadze, "Georgia Signs Unfavorable New Natural Gas Transit Deal With Russia", The Jamestown Foundation, 2017, https://jamestown.org/program/georgia-signs-unfavorable-new-natural-gas-transit-deal-russia/

4.3 Implications of the new transit deal

With the new deal, the risks for Georgia's energy security might increase in the short to medium term. The previous gas transit terms were more advantageous for Georgia than the new ones, as Georgia will not be able to buy same volumes through the monetization scheme that it used to receive under the previous in-kind contract for transit service (10 percent of transited gas; 200 mcm/a), and the additional Russian gas received on the top of 200 mcm/a has been crucial for maintaining low tariffs. This means that Georgia will have to buy this 200 mcm/a and additional gas on commercial terms when there is need to cover winter peak demand in the country, and will have to equilibrate demand in the social gas market and control tariffs for social gas packages to protect vulnerable consumers.[122] Otherwise, gas and electricity tariffs will inevitably rise, which will produce discontent among the people towards the ruling government.[123]

Critics of the new agreement consider it economically disadvantageous, because payment in raw materials is a more favorable mechanism due to its immunity to price fluctuations and currency devaluations compared to payment in money.[124] Moreover, the price Gazprom charges Armenia for gas has been reduced several times ($150/1000m^3), thus the money Gazprom pays for transit services after 2018 might not be sufficient for Georgia to purchase adequate quantities of gas corresponding to the volumes of transit gas received in previous years.[125]

According to the statement of the World Experience of Georgia (WEG), with this agreement the country "loses the benefits of receiving in kind gas and becomes more vulnerable to gas price volatility" and "will receive less value than it could get from natural gas according to the previous agreement." The price at which Georgia is envisaged to receive additional gas is ($185) higher than the price for Armenia ($150) and is envisaged for the social gas sector only in the case of gas deficit, whereas plans to supply the commercial sector with additional Russian gas remain unclear yet. Although the monetary settlement for transit is in accordance with international practice and WTO rules, the new transit conditions are inferior to the previous ones in terms of economic and energy secu-

122 Jervalidze, "On the Agreement between Gasprom.. and Georgia…", *op.cit.,* p.1; Jervalidze, "Georgia's Gas Market..", *op.cit.* p.12.

123 Giorgi Menabde, "Gazprom Ups Pressure On Georgia With New Gas Transit Deal", Oil Price, January 2016, http://oilprice.com/Latest-Energy-News/World-News/Gazprom-Ups-Pressure-On-Georgia-With-New-Gas-Transit-Deal.html

124 Nutsa Galumashvili, "Gazprom'S Victory: Russian Gas Giant To Pay Money For Gas Transit Via Georgia", Caucasus Business Week, 2017. http://cbw.ge/economy/gazproms-victory-russian-gas-giant-pay-money-gas-transit-via-georgia/.

125 Liz Fuller, "Georgian Transit Agreement With Gazprom Under Fire", RadioFreeEurope/RadioLiberty, 2017, https://www.rferl.org/a/georgia-russia-gas-agreement-armenia/28256580.html

rity. The WEG statement highlights that the negotiations with Gazprom were conducted behind closed doors, without proper preparation, risk analysis, or the involvement of international or local experts and civil society, and without discussions being held with the participation of relevant government and security stakeholders to reduce risks, thus raising certain doubts on the compliance of the negotiations with the country's interests.[126]

However, it emerged after the new deal that to comply with Georgia's Association Agreement with and prospective membership of the EU, the country is obliged to receive the transit fee in money, but not in kind as the commodity, but with this money can purchase as much gas as it needs to cover gas shortage. Therefore, the new deal with Gazprom can be also seen as a part of Georgia's international obligations.[127] However, if Russian gas becomes more expensive in the future—above the initially negotiated price ($185)—then Georgia will face hurdles in obtaining similar volume of gas to those it was previously receiving from transit. On the other hand, the NSGP does not fall under EU regulation as, according to the membership protocol of Georgia, gas transit agreements are exempt from the requirements of EU directives.[128]

Another aspect of the agreement is that, in contrast to the previous agreement signed for 15 years, it is for a two-year term only, after which Georgia may face unfavorable new contractual terms. The preferential price, set at $185, is intended for the purchase of social gas, but is more expensive than SOCAR's social gas prices. Given that natural gas prices in Europe have considerably declined in recent years, Gazprom's price does not look particularly advantageous. Actually, the talks on monetization were not new. In 2005, Russia had offered an appealing sum and lucrative gas prices to the then Georgian government in exchange for selling major transit and communication routes. Georgia's rejection of that offer resulted in the suspension of Gazprom's gas supply to the country. On the other hand, Armenia will be an additional beneficiary of the deal because, as a member of the Eurasian Economic Union, Armenia gets the full benefits of preferential tariffs from 2017. If larger volumes of Russian gas are supplied to Armenia, Gazprom will not lose from the tariffs in money, which was not a case for the tariffs in commodity. Enhanced volumes of Russian gas supply to Armenia can also outmaneuver Iran as a potential provider. This is a win-win scenario for Gazprom, a relative win for Armenia

126 "WEG Statement on Gazprom Export Negotiations", World Experience for Georgia, 2017, http://weg.ge/en/weg-statement-gazprom-export-negotiations

127 Liana Jervalidze: «Georgia is looking forward for launch of the Southern Gas Corridor", Vestnikkavkaza.net, 2017, http://vestnikkavkaza.net/interviews/Liana-Dzhervalidze-Georgia-is-looking-forward-for-launch-of-the-Southern-Gas-Corridor%E2%80%99%E2%80%99.html

128 "WEG Statement on Gazprom Export Negotiations", *op.cit.*

(excluding its increased dependence on Gazprom), and an inconvenience for Georgia and Iran.[129]

4.4 Rationale behind the decision of Georgian government

It should be acknowledged that the new transit deal does not envisage traditional "take-or-pay" or "use-or-pay" clauses, unlike Gazprom's traditional contracts. Georgia can likely buy extra gas from Gazprom under commercial terms at $185 when needed to meet winter peak demand in the country (the previous 200 mcm of transit gas was mostly used during winter).[130]

In addition, there are expectations that Georgia will be able to receive more gas from Azerbaijan when the SD2 and Absheron fields come on-stream in 2018 and 2020, respectively; as well as from Turkmenistan or Iran via the SGC. Although the terms of the new transit agreement are financially less profitable for Georgia, nevertheless, the share of Russian gas in Georgia's gas balance will not increase dramatically in the medium to long term,[131] as SOCAR, in accordance with an agreement reached in March 2016, will manage to supply the necessary volumes during winter peaks. Azerbaijan's share in Georgia's gas market was approximately 95 percent, but it may rise to 100 percent once Gazprom initiates payment of the transit fee to Georgia in cash.[132] With the small volumes of additional gas purchases, as before, Gazprom is unlikely to obtain controlling access in the Georgian gas market and SOCAR, based on its current performance, will most likely remain a key supplier of gas under its contractual competences.

SOCAR still remains a main gas provider for small private consumers and commercial companies. However, if there is a gas shortfall among private/commercial companies, they are, in accordance with their contracts with third gas suppliers, eligible to seek alternative gas sources, including from Russia to, balance their gas supply shortages. Therefore, currently only commercial companies buy Russian gas, but not the Georgian government.[133] Currently, the Georgian government has not signed any additional commercial gas purchase agreement with Russia. However, Georgia can look at other diversification options when the price offered by a third supplier is lower and supply is secure.[134] Georgia can opt to buy Russian gas only in the case of emergency (if there is a seasonal

129 "All-in or Fold: Gazprom's Geopolitical Card Play with Georgia", Georgia Today, 2017, http://georgiatoday.ge/news/5687/All-in-or-Fold%3A-Gazprom%E2%80%99s-Geopolitical-Card-Play-with-Georgia
130 Jervalidze, "On the Agreement between Gasprom.. and Georgia…", *op.cit.,* p.3-4.
131 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.13.
132 Interview with official (2) of GOGC in Georgia.
133 Interview with official (3) of GOGC in Georgia.
134 Interview with official (2) of GOGC in Georgia.

shortage) or can compensate this shortage at the expense of electricity imports (from Azerbaijan, Russia and Armenia). Previously, additional purchases of Russian gas were deducted from the transit volume (for gas to Armenia) of the upcoming year.[135]

Georgia could not refuse to sign the new agreement with Gazprom Export and merely continue its illegal offtake of Russian gas transported to Armenia. Otherwise, Gazprom Export would bring the Georgian government before the arbitration court for illegal deduction of gas. Moreover, Russia and Armenia could agree to identify the Georgia–Russia border as the sale point for gas transit to Armenia, instead of the Georgia―Armenia border. In this case Georgia would negotiate gas transit terms with Armenia, not with Gazprom, under the Energy Charter terms and conditions. Georgia could not block gas supplies to Armenia, as the former has committed under the Energy Charter, WTO, and the EU Association Agreement to ensure uninterrupted transit of commodities across its territory. Otherwise, Gazprom Export could challenge the country in the court for defaulting on its commitments. This would undermine Georgia's relations with Armenia, as well as its reputation as a reliable transit country.[136] In that case, Georgia would have lost not only the transit revenues, but also the gas volume which comes from Russia.[137] By accepting Gazprom's 'take-it-or-leave-it' ultimatum, Georgia managed to preserve its transit function.[138] Moreover, Gazprom's alleged ultimatum to Georgia that it would supply natural gas to Armenia via Iran if Georgia did not accept the monetization mechanism was apparently an intimidatory bluff, because the limited throughput capacity of the Iran–Armenia gas pipeline would not be sufficient to deliver as same volume of gas as the route through Georgia.[139]

Moreover, a few days before the deal with Gazprom was signed, former energy minister Kaladze announced that: "Since April 2017, Georgia will completely switch to supplying the population and enterprises with gas from Azerbaijan," in accordance with the agreement reached with Azerbaijan's SOCAR and the Shah Deniz consortium[140] to supply a total of 2.347 bcm of gas to cover its domestic requirements. According to estimations, in 2017, Georgia will receive 2.457 bcm of gas, of which deliveries from Azerbaijan will amount to 2.347 bcm (95.5 percent). Thus, the share of Russian gas in

135 Interview with an official (4) from Ministry of Energy of Georgia.
136 Jervalidze, "On the Agreement between Gasprom.. and Georgia…", *op.cit.,* p.3-4.
137 «Supplied Gas Price To Armenia To Drop?», Aravot, 2017, http://www.aravot-en.am/2017/01/17/187646/.
138 Fuller, *op.cit.*
139 Merab Galumashvili, "Gazprom's Victory: Russian Gas Giant to Pay Money for Gas Transit via Georgia", 2017, http://cbw.ge/economy/gazproms-victory-russian-gas-giant-pay-money-gas-transit-via-georgia/
140 "Georgia To Completely Switch To Gas Supply From Azerbaijan", Azernews.Az, 2017, https://www.azernews.az/oil_and_gas/111345.html.

the total volume of imports will amount to only 4 percent.[141] This is expected to help the country to obviate the need to purchase any additional Russian gas in 2017 and deflect temporarily the public criticism for the recent deal with Gazprom.[142] These long-term negotiations were most probably related to the Georgian government's precaution, ahead of the parliamentary elections of October 2016, not to trigger public anger over 'concessions to Russia', which could play into the hands of opposition parties. Due to the post-election internal squabbling within opposition parties, the ruling GD has gained more self-confidence in the negotiations with Gazprom against the resistance from the opposition.[143]

Meanwhile, in the coming years Georgia will need to address some issues concerning its gas supply. According to Georgia-based expert Liana Jervalidze, Georgia will have to renegotiate and conclude new supply/transit contracts with the Shah Deniz and SCP consortiums, as their respective contracts expire by 2025 and 2022 for supplemental and optional gas, respectively; as well as negotiate with Gazprom Export, since the new two-year contract on Russian gas transit to Armenia comes to an end in 2018. As Jervalidze argues, the gas obtained through these contracts is essential in order to ensure long-term security of gas supply and to maintain affordable tariffs levels for household consumption and power generation.[144]

4.5 Russia–Armenia (North–South) Gas Pipeline (NSGP)

Passing through Georgian territory to supply gas for Armenia, NSGP is one of the key issues in Georgia's, as well as Russia's, energy policy. In November 2016, the finance minister of Georgia, Dimitri Kumsishvili, announced that the Georgian government was considering selling a 25 percent stake in GOGC on the international financial market in 2017.[145] GOGC also operates the NSGP, which stretches from the Georgia–Russia border to the Georgia–Armenia border and supplies Georgia and Armenia with natural gas.[146] Meanwhile, Azerbaijan's SOCAR disclosed its interest in obtaining shares in GOGC, if the tender for sale was officially announced.[147] Speculations were spreading that if SOCAR

141 «Georgia To Abandon Purchasing Gas From Russia», Trend.Az, 2017, https://en.trend.az/business/energy/2741215.html.

142 "Azerbaijan To Provide Georgia With Alternative...", *op.cit.*

143 «Сделка Грузии с Газпромом выгодна обеим сторонам", *op.cit.*

144 Jervalidze, "Georgia's Gas Market..", *op.cit.* p.13.

145 Nutsa Galumashvili, "Georgia To Sell 25% Stake In State Energy Firm GOGC In 2017", Caucasus Business Week, 2016, http://cbw.ge/economy/georgia-sell-25-stake-state-energy-firm-gogc-2017/.

146 See official website of Georgian Oil and Gas Corporation - "International Projects", www.gogc.ge/en/saertasoriso-proeqtebi

147 "Azerbaijan Considers Buying Shares Of Georgia'S GOGC", Trend.Az, 2016, https://en.trend.az/business/energy/2690987.html.

purchase the GOGC stake, it would also be able to control the NSGP, which was of great concern for Armenia.

A similar situation was previously observed in 2005, when the Georgian government under former president Mikheil Saakashvili was holding active talks with Russia for the sale of the Georgian section of the NSGP to Gazprom for $300 million. As the gas transmission system of Armenia is fully owned by Gazprom, by purchasing the Georgian section of the pipeline, Gazprom could interconnect and control the gas transmission system of Georgia and Armenia, with access to Iran.[148] However, the sale of the pipeline to Russia was delayed after the US allocated $70 million within the framework of the Millennium Challenge program for rehabilitation of the NSGP. Under that agreement, Georgia undertook not to sell the pipeline for five years (until April 2011).[149] Subsequently, in March 2006, the Georgian government reiterated its intention to sell the pipeline to Gazprom in return for a binding agreement to postpone the planned price increase of Russian gas from $110 to $230/1000m^3. Reportedly, Russia's Gazprom had offered $250 million for the acquisition of the pipeline, but the Georgian government set the price at $1 billion. In 2008, Georgia received additional funding from the Millennium Challenge program for the second stage of rehabilitation of the pipeline.[150]

In 2010, the same issue emerged again, when Azerbaijan's SOCAR allegedly offered the Georgian government $500 million to purchase the available stake in the Georgian section of the NSGP.[151] Prior to that, in July 2010, the Georgian parliament passed a draft law removing the NSGP from the list of strategic state assets, thus lifting restrictions on the sale of the pipeline. Lawmakers in the parliamentary minority argued for retaining a controlling stake in the pipeline. They proposed an amendment in the draft law that would allow a sale of no more than 49% of the pipeline, with the concern that Russia may purchase it. However, the ruling party rejected the proposal, arguing that it was an economic issue as part of the government's free market policy and it should not be politicized.[152]

Armenia, which receives a major share of its gas supply via this pipeline, was

148 "Зачем Москва заигрывает с Грузией?", Noviy Region, November 2015, nr2.com.ua/blogs/Ksenija_Kirillova/Zachem-Moskva-zaigryvaet-s-Gruziey-111636.html

149 "Минэнерго Грузии: США помешали Михаилу Саакашвили продать «Газпрому» газопровод", Kommersant, October 2015, www.kommersant.ru/doc/2836511; "США ранее запрещали Грузии продавать свой газопровод Газпрому", Georgia News, October 2015, georgia-news.org/politika/659-ssha-ranee-zapreschali-gruzii-prodavat-svoy-gazoprovod-gazpromu.html#sel=

150 "Georgia's Main Gas Pipeline Up For Grabs", Radiofreeeurope/Radioliberty, 2010, https://www.rferl.org/a/Georgias_Main_Gas_Pipeline_Up_For_Grabs/2095528.html; "Proposal Lifting Ban On Sale Of Trunk Gas Pipeline Passed With First Reading", Civil.Ge, 2010, http://www.civil.ge/eng/article.php?id=22492.

151 "Georgia Says Will Not Sell Key Gas Pipeline (UPDATED)", Azernews.Az, 2010, https://www.azernews.az/oil_and_gas/23827.html

152 "Proposal Lifting Ban On Sale Of Trunk Gas Pipeline..", *op.cit.*

concerned that Azerbaijan's SOCAR, by purchasing the pipeline, would be able to block gas delivery from Russia to Armenia. Although Armenia imports natural gas from Iran as well, the country is still strongly reliant on Russian gas imports. Therefore, Armenia insisted that Georgia did not sell the pipeline to Azerbaijan. Georgia's former prime minister, Nika Gilauri, then stated that the Georgian government would not sell a controlling stake in the pipeline, but only a minority share in the facility, remaining the principal owner. In 2011, Georgia's former energy minister, Aleksandr Khetaguri had announced the intention of Georgia to sell, however, a minority stake (25 percent) in the pipeline on the stock exchanges of New York, London and Warsaw.[153] In 2015, another former energy minister of Georgia, Kakha Kaladze, reiterated that Georgia is not going to sell this pipeline, notably not to Gazprom, due to its strategic importance. [154] Otherwise, Georgia would be left without political and economic leverage in its relations with Russia.

If SOCAR bought a 25 percent stake in the GOGC, it would have a voice in the operation of Georgia's domestic natural gas transmission system, and subsequently in international cross-border gas transit from either Russia or Iran (via Armenia). However, SOCAR will not hold a controlling stake with 25 percent. Even if Azerbaijan gained, by purchasing the Georgian section of the NSGP, strategic leverage over Armenia, the former would hardly cut off the gas supply therethrough because SOCAR will not contradict the terms of the intergovernmental agreement (IGA) on gas transit from Russia to Armenia via Georgia based on political motivations; otherwise, it would render the Georgian government responsible under the terms of the IGA. Since Russia's gas exports are at stake, Azerbaijan would be unlikely to confront Russia. Moreover, while the strategic value of the pipeline remains undisputed, the economic gains of SOCAR would be reduced.

153 "Georgia To Sell Armenia Section Of Gas Pipeline", Asbarez.Com, 2011, http://asbarez.com/97644/georgia-to-sell-armenia-section-of-gas-pipeline/; "Azerbaijan Offers $500 Million For Georgia-Armenia Gas Pipeline", Asbarez.Com, 2010, http://asbarez.com/84460/azerbaijan-offers-500-million-for-georgia-armenia-gas-pipeline/

154 "Российский газ по душе Грузии", GeorgiaNews, October 2015, georgia-news.org/obshestvo/615-rossiyskiy-gaz-po-dushe-gruzii.html

CHAPTER V

5. Iran: Emerging Gas Supplier for Georgia?

5.1 Iran's gas export plans after sanctions

Iran owns the world's second largest proven gas reserves, holding 34 trillion cubic meters of gas.[155] However, historically the country has not been able to fully benefit from its huge potential and become a major player in the global gas trade for a number of reasons, mainly because of the sanctions imposed by the US and the EU, and an internal legal and contractual regime unfavorable for investment. The impact of US sanctions on the Iranian economy in general and on the gas industry in particular was enormous. In 2010, the US Congress passed the Comprehensive Iran Sanctions Accountability and Divestment Act, which expanded the scope of the Iran Sanctions Act (1996), and banned investment in any pipeline project in Iran, transit through Iran, and sales of energy-related equipment to Iran. A year later, in 2011, the EU announced a new range of sanctions which went beyond the US sanctions and banned sales and purchase of oil and petrochemicals. Later, in 2012, EU member states approved additional sanctions banning import of natural gas from Iran and financial transactions between European and Iranian banks. As a result, the European and Asian investors and oil and gas majors withdrew from Iran's energy projects, including the South Pars Field project. This has made the country unable to capitalize on its huge natural gas reserves and to duly develop its energy industry potential.

On July 14, 2015 Iran and the P5+1 countries[156] agreed on a Joint Comprehensive Plan of Action concerning Iran's nuclear program, according to which Iran is obliged not to develop and acquire nuclear weapons. In return, the international community committed to remove sanctions, as the JCPOA stipulates the removal of sanctions on the "import/export and transport of Iranian oil/gas products and technologies; participation in joint ventures and investment for the oil/gas sectors; purchase, acquisition, sale, transportation or marketing of oil/gas from Iran."[157] The removal of sanctions will pave the way for Iran's natural gas exports to Europe.

155 Cedigaz Natural Gas Statistical Database 2015
156 Permanent members of the UN Security Council (UK, China, France, Russia, the U.S) + Germany
157 "Joint Comprehensive Plan of Action", Vienna, July 2015, http://eeas.europa.eu/statements-eeas/docs/iran_agreement/iran_joint-comprehensive-plan-of-action_en.pdf

However, Iran's gas export potential in the next decade will not exceed 30 bcm/a. Whether it will actually reach this level will depend on Iran's capacity to attract sufficient foreign investment, as Iranian gas production growth will require billions of dollars to be injected in the upstream and midstream industry within the next 5–6 years. The export volumes will be limited as domestic demand will inevitably grow rapidly and as Iran will need more gas for reinjection in oil fields, further gasification of the country, the petrochemical industry, and to substitute power plants fired by heavy oil with gas to meet its growing electricity needs. Iran currently faces a shortage of financial means and liquidity impacting all spheres of the economy. The Iranian government will need to invest an estimated $500 billion to revive an economy that has been weakened by sanctions and prolonged isolation and to strengthen the weak national currency. Iran had $100 billion of oil and oil products trade assets, frozen when sanctions were imposed, unfrozen; but half of this unfrozen amount has already been spent to service Iran's international debts.[158] The development timeframe of the 11 phases of South Pars and other onshore fields to produce the additional volumes of gas will strongly depend on Iran's ability to attract multibillion dollars of foreign investment in the upstream and midstream industry as well as to create a favorable legal and contractual framework.

5.2 Does Georgia plan to import Iranian gas?

Along with Russian gas, Georgia was also not excluding importing Iranian gas. There is a MoU between Iran and Georgia, signed a long time ago and since renewed, with the purpose of supplying Georgia with gas when there is gas shortage in the country.[159] Following the lifting of international sanctions, Iran had proposed to sell Georgia up to 14 mcm/d of Iranian gas via Armenia.[160] In February 2016, Ali-Reza Kameli, managing director of the National Iranian Gas Company (NIGC), announced that the Georgian public and private sectors were interested in buying gas from Iran,[161] and two countries had reached a preliminary agreement on the delivery of 300–500 mcm of Iranian gas to Georgia via Armenia utilizing the existing pipelines on the territory of Armenia.[162] Reportedly, Iran was expected to supply around 300–500 mcm of gas to the Iran-Armenia border for Georgia (for use in power generation), and Georgia would accept this volume at its border

158 "Координатор из США: на погашение долгов Ирана ушло $50 млрд из его размороженных счетов", Itar Tass, 2016, http://tass.ru/mezhdunarodnaya-panorama/2660193
159 Interview with official (2) of GOGC in Georgia.
160 Lomsadze, "Iran Joins Georgia's Caucasian Gas Circle", *op.cit.*
161 "Iran Likely to Export 200 mcm Gas to Georgia", Shana, February 2016, www.shana.ir/en/newsagency/255312/Iran-Likely-to-Export-200-mcm-Gas-to-Georgia-CEO
162 «Грузия нажала на газ», Novoye-vremya, January 2016, www.novoye-vremya.com/w54209/.../#.Vu-nzvmLTIV

with Armenia. [163] However, at that time, Georgia rejected the NIGC's statement, as there was no tangible agreement on gas supply.[164]

On July 18, 2016 Ali-Reza Kameli reiterated that Tehran was ready to export gas to Georgia within the next two months. Iranian gas would be supplied to Georgia based on a short-term agreement from a gas compressor station in the village of Nordooz in Iran, on the border with Armenia, which is used for gas delivery to Armenia. The capacity of this station would permit supplying additional Iranian gas to Georgia. Iran has built a pipeline that traverses 113 km between its northwestern city of Tabriz and the Nurduz border crossing to export gas to Armenia. In 2004, the construction of the Iran–Armenia gas pipeline (IAGP) was initiated, and the pipeline became fully operational in 2007.[165] Later, Kameli stated that Iran's NIGC had already signed a four-month pilot agreement with the Georgian private company "Georgian International Energy Corporation." Under the agreement, around 40 mcm of Iranian gas would be exported to Georgia through Armenia within a four-month period.[166] Iran's Minister of Petroleum, Bijan Zanganeh, said that if the trial proved successful, Iran would finalize the agreement to export gas to Georgia.[167] Zanganeh added that Iran had endorsed an Armenian proposal on the formation of a new organization that will be responsible for implementing the new contracts for direct gas sales to Armenia and for gas transit to Georgia. This would replace the contract with "Yerevan Thermal Power Plant," a current recipient of Iran's gas for Armenia, since Yerevan TPP does not possess the necessary permits to transmit the gas to further destinations.[168] The new company is called "Energaimpex."[169]

However, Georgia's former deputy energy minister, Mariam Valishvili, stated that the, "Ministry of Energy has no information on the conclusion of contracts for the import of Iranian gas to the country, neither the Georgian government has concluded such contracts. Georgian legislation does not [however] forbid the private companies to sign such a contract." According to the MoE, no contract so far has been submitted to the attention of the Georgian government

163 "Ministry: Route for transportation of Iranian gas to Georgia unknown", Apa.az, January 2016, en.apa.az/xeber_ministry__route_for_transportation_of_ir_237386.html

164 "Достижение договоренности о поставках газа из Ирана в Грузию оказался фейком", GeorgiaNews, January 2016, georgia-news.org/politika/999-dostizhenie-dogovorennosti-o-postavkah-gaza-iz-irana-v-gruziyu-okazalsya-feykom.html

165 "Iran to Finalize Project to Export Gas to Georgia in Weeks", Tasnim News Agency, 2016, https://www.tasnimnews.com/en/news/2016/07/18/1133728/iran-to-finalize-project-to-export-gas-to-georgia-in-weeks

166 "Iran, Georgia sign deal 40 mln cubic meters gas deal", ISNA, 2016, http://en.isna.ir/news/95050105554/Iran-Georgia-sign-deal-40-mln-cubic-meters-gas-deal

167 "Iran to triple gas exports to Armenia", Presstv.ir, 2017, http://www.presstv.ir/Detail/2016/07/27/477172/Iran-to-triple-gas-exports-to-Armenia

168 "Tehran, Yerevan Reach New Gas Deal", Asbarez.com, 2016, http://asbarez.com/153347/tehran-yerevan-reach-new-gas-deal/

169 "Armenia to Set Company to Expand Iran Natural Gas Imports", Asbarez.com, 2016, http://asbarez.com/153632/armenia-to-set-company-to-expand-iran-natural-gas-imports/

for registration.[170] However, Valishvili reported that a supply swap arrangement using transit infrastructure from Iran to Georgia and from Russia to Armenia should be discussed in a quadripartite format, but Georgia has not conducted any negotiations towards this.[171] On the other hand, Armenia's participation in such projects is tantamount to Russian participation, since Armenia's gas pipelines system is controlled by Gazprom.[172] Despite a rebuttal from the Georgian side, Armenia's *Panarmenian.net* news portal reported, with reference to Armenia's State Revenue Committee, that 24.7 mcm of gas amounting to a value of $6.2 million ($250/1000 m^3) was exported via Armenia to Georgia in the first six months of 2016. The exact source of the gas and the means of transportation was not indicated; however, the source reports an Iran–Georgia agreement on the purchase of 500 bcm of gas.[173]

5.3 Armenia wants to boost Iranian gas imports

Armenia currently imports up to 500 mcm/a of Iranian gas through the IAGP built in 2008 in accordance with the gas contract signed in 2004. According to the contract, Iran barters gas against power, providing natural gas to Armenia's state-owned thermal-power plant in exchange for electricity delivered back to Iran under the swap arrangement.[174] The swap arrangement is due to be expanded significantly following the construction of a third transmission line connecting the Armenian and Iranian power grids by 2019. The contract provides for the supply of a maximum of 2.3 bcm/a (i.e., 6 mcm/d), but the actual traded volume has never reached its maximum capacity.[175] The main technical issue with the pipeline is its extremely small capacity. Armenia does not have any control over its gas transmission system, preventing it from expanding its import capacity. Gazprom's subsidiary, "Gazprom Armenia" (former ArmRosGazprom), owns 100 percent of the shares of the country's gas transmission system.[176]

Officials from Armenia's MoE have frequently signaled their willingness to buy

170 Interview with an official (4) from Ministry of Energy of Georgia.
171 "Georgia denies information on Iranian gas import", Trend, July 2016, https://en.trend.az/business/energy/2564283.html
172 "Georgia should settle energy issues in partnership with Azerbaijan", Trend, August 2016, https://en.trend.az/business/economy/2565242.html
173 "$6,2 mln worth gas shipped to Georgia from Armenia", PanARMENIAN.Net, 2017, http://www.panarmenian.net/eng/news/220067/62_mln_worth_gas_shipped_to_Georgia_from_Armenia
174 «Armenia, Iran Sign Deal To Increase Gas Imports, Power Flows», Radiofreeeurope/Radioliberty, 2016, https://www.rferl.org/a/armenian-iran-sign-deal-increase-gas-imports-power-flows/28092312.html.
175 "The Week In Review For Caspian Gas, Including Iran And Azerbaijan", Naturalgasworld.Com, 2015, https://www.naturalgasworld.com/greater-caspian-weekly-overview-december-11th-2015-27078.
176 "Gazprom Increasing Its Stake In Armrosgazprom To 100 Per Cent", Gazprom.Com, 2014, http://www.gazprom.com/press/news/2014/january/article182633/.

more natural gas (2 bcm/a) from Iran.[177] The NIGC has recently confirmed that the company wants to sign an agreement with Armenia to increase the gas supply. According to NIGC, if Armenia is interested in obtaining large volumes of gas from Iran, the company would prefer to conclude a separate direct contract with Armenia (other than an agreement for "gas in exchange for electricity") to increase the volume of gas supplies. Thus, that additional gas would be purchased directly, i.e. in money, but not with electricity, which would allow Iranian gas to be supplied to Armenian consumers too (population and enterprises).[178] Armenia's requests for growth in Iranian gas exports were positively received by Iranian President, Hassan Rouhani, during the latter's official visit to Yerevan in December 2016. Rouhani said that Iran will increase exports of natural gas to Armenia, but without specifying the volume of additional gas supplies. Reportedly, Armenia's Energaimpex company and the NIGC had already signed a MoU for the transit, sale and purchase of gas, as well as to increase gas imports from Iran; however, again, the MoU did not specify how much more gas will be imported. Reportedly, Iran plans to triple gas exports to Armenia by 2019 (from 1 mcm/d (360 mcm/a) to 2–3 mcm/d (1.08 bcm/a)[179]) and will also sell gas to Georgia through Armenia.[180] Apparently, Armenia plans to re-export some of the additional volume of Iranian gas to Georgia, a proposal that has also been endorsed by Iran, [181] as Iranian officials did not exclude using Armenia's territory as a transit route for Iran's gas exports to Georgia and to Europe.[182] In addition, Iran will serve as a transit route for Armenia's gas imports from Turkmenistan.[183] However, this might be also connected to Gazprom's plans to swap electricity generated at the Hrazdan TPP in Armenia in exchange for Iranian gas.[184]

However, Armenia's deputy minister of energy, Hayk Harutyunyan, later said that, despite constant negotiations, no concrete results have yet been achieved on the increase of Iran's gas exports to Armenia.[185] Armenia's PM, Karen Karapetyan, made a more precise statement that no negotiations are being conducted

177 "Armenia keen to import Iran's natural gas", English.khabaronline.ir, 2017, http://english.khabaronline.ir/detail/186440/Islamic-Republic-of-Iran--gas-/Economy/Economy
178 "Армения и Иран ведут переговоры о поставках дополнительных объемов газа - иранский чиновник", Радио Свобода, 2017, https://rus.azatutyun.am/a/28688520.html
179 "Armenia, Iran Initiate MoU On Natural Gas Transit, Sale", Asbarez.Com, 2016, http://asbarez.com/156561/armenia-iran-initiate-mou-on-natural-gas-transit-sale/.
180 "Iran, Armenia sign MoU to increase gas imports from Iran", IranOilGas Network, 2017, http://www.iranoilgas.com/news/details?id=16777&title=Iran%2C+Armenia+sign+MoU+to+increase+gas+imports+from+Iran+
181 "Armenia, Iran Sign Deal To Increase Gas Imports, Power Flows", Payvand.Com, 2017, http://www.payvand.com/news/16/nov/1015.html.
182 "Iran to Increase Gas Exports to Armenia", Egypt Oil & Gas, 2017, http://www.egyptoil-gas.com/news/iran-to-increase-gas-exports-to-armenia/
183 "Hassan Rouhani's Visit Deepens Economic Ties Between Iran and Armenia", Massis Post, 2016, https://massispost.com/2016/12/hassan-rouhanis-visit-deepens-economic-ties-iran-armenia/
184 «Gazprom Sees Potential For Swaps With Armenia'S Electric Power And Iranian Gas», TASS, 2017, http://tass.com/economy/935689.
185 "Armenia never stopped talks with Iran on greater volumes of gas delivery", Arka.am, 2017, http://arka.am/en/news/business/armenia_never_stopped_talks_with_iran_on_greater_volumes_of_gas_delivery_deputy_minister_says_/

at this point, referring to the lack of economic benefits in terms of price,[186] because Russian gas has a lower price that is unacceptable to Iran. NIGC also underlined that since Armenia and Georgia have not finalized negotiations on gas transit to the latter via the former's territory, the gas purchase agreement between Iran and Georgia cannot be implemented yet.[187] Armenia's President, Serzh Sargsyan, discussed energy-related projects with President Rouhani during his visit to Iran,[188] stated that Armenia is interested in participating in major regional economic projects, however, such a large-scale project, i.e., "the issue of the transit of Iranian gas to Europe [via Armenia and Georgia] should be comprehensively studied, calculated at the level of experts" to determine "if it is economically beneficial for all parties."[189]

5.4 Armenia seeks to build its role as a transit state

Moreover, Armenia is seeking to import Turkmen gas (which is lower cost compared to Iranian gas). As soon as Karen Karapetyan, who had previously managed Armenia's gas distribution network as a Gazprom official, took the position of Prime Minister in Armenia, he quickly pooled all efforts to expand Armenia's infrastructure capabilities and attract foreign investment to ensure the energy independence of Armenia by seeking new options for natural gas supply. In this regard, Karapetyan has also sought to strengthen energy cooperation with Iran and Turkmenistan. For this purpose, on January 9, 2017, he received the Iranian and Turkmen ambassadors to discuss the possible supply of Turkmen natural gas to Armenia via Iran through a trilateral swap operation and paid an official visit to Turkmenistan on March 28, 2017. Armenia's deputy energy minister, Hayk Harutyunyan, discussed prospective gas trade with his Turkmen counterpart and the chairman of state-owned "Turkmengaz." Turkmenistan had been previously supplying Armenia with natural gas in the 1990s, until Armenia signed a long-term gas purchase deal with Russia's Gazprom.

Since Turkmenistan is heavily dependent on gas exports in the direction of China, and Russia has suspended purchase of Turkmen gas, the country is also seeking new markets to diversify its exports, in addition to Iranian.[190] However, the delivery of Turkmen gas through Iran to Armenia was questioned due to a financial dispute between Tehran and Ashgabat and the lack of adequate pipe infrastructure

186 "Armenia PM says talks on increasing gas supplies from Iran are not currently held", News.am, 2017, https://news.am/eng/news/405878.html

187 "Iran Wishes to Sign New Gas Agreement with Armenia", Lragir.am, 2017, http://www.lragir.am/index/eng/0/politics/view/37323

188 "President Sargsyan Attends Iranian President's Inauguration", The Armenian Mirror-Spectator, 2017, https://mirror-spectator.com/2017/08/08/president-sargsyan-attends-iranian-presidents-inauguration/.

189 "Армения и Иран ведут переговоры о поставках…", *op.cit.*

190 «Turkmenistan Says Ready For Iran Gas Talks», Iran-Daily.Com, 2017, http://iran-daily.com/News/176520.html.

in Iran. Reportedly the only option, the swap operation, had temporally stalled due to a controversy between Turkmenistan and Iran on cutting off gas supplies to Tehran because of Iran's debt stemming from the NIGC's failure to abide by the "take or pay" provision of the gas supply contract.[191] Turkmenistan unilaterally halted gas supplies to Iran in January 2017, demanding that former to settle a $2bn unpaid debt that allegedly remained outstanding from previous imports.[192] Meanwhile, Ashgabat, in violation of the terms of its contract with Iran, had increased gas prices to $360 from $40.[193] Representatives from both countries had urged that they take the dispute to the International Court of Arbitration.[194]

However, Iran's NIGC stated that "although Turkmens have discontinued gas exports to Iran, we hold no plans to terminate gas swap with the neighboring country" and around 6 mcm/d of Turkmen gas is swapped through Iran to Azerbaijan.[195] NIGC's managing director, Hamid Reza Araqi, said that, notwithstanding the dispute between two countries, they will continue with their swap deals. Iran has remained committed to its contracts in the gas trade with Turkmenistan and did not hesitate to export gas to Azerbaijan under a swap deal with Turkmenistan despite Ashgabat's lack of commitment to the contract. Iran receives Turkmen gas from the northeast and delivers it to Armenia and Azerbaijan in the northwest, said Araqi, without referring to the volume of the swaps.[196] Turkmenistan has even proposed an increase of 10 mcm/d (to 15 mcm/d) in its current level of gas swap through Iran for Azerbaijan and Armenia. The NIGC later claims that Iran has settled its debts to the Turkmengaz, the Turkmen state gas company.[197]

There might be a very close connection between Iranian President Hasan Rouhani's statement (during his visit to Armenia) of his country's readiness to serve as a transit route for Armenia's gas imports from Turkmenistan[198] and Armenia's willingness to increase gas imports from Iran and transfer them to Georgia. Armenia is therefore desperately hopeful for the implementation of the second

191 «Turkmenistan Says It Is Ready To Continue Talks With Iran On Gas Row», Zawya.Com, 2017, https://www.zawya.com/mena/en/story/Turkmenistan_ready_to_continue_talks_with_Iran_on_gas_row-TR20170126nL5N1FG121X3/.

192 "PressTV-New pipeline cuts Iran's reliance on Turkmen gas", Presstv.ir, 2017, http://www.presstv.ir/Detail/2017/08/02/530462/Iran-gas-pipeline-Turkmenistan-Mazandaran

193 "New Pipeline Will End Iran's Need for Turkmen Gas", Financial Tribune, 2017, https://financialtribune.com/articles/energy/69095/new-pipeline-will-end-irans-need-for-turkmen-gas

194 «Iran Ready For Talks On New Gas Deal With Turkmenistan: Official», Tasnim News Agency, 2017, https://www.tasnimnews.com/en/news/2017/01/28/1309902/iran-ready-for-talks-on-new-gas-deal-with-turkmenistan-official.

195 «Iran To Sue Türkmengaz For Halt In Gas Exports», Mehr News Agency, 2017, http://en.mehrnews.com/news/122982/Iran-to-sue-T%C3%BCrkmengaz-for-halt-in-gas-exports.

196 «Despite Conflict With Turkmenistan, Iran Delivers Gas To Azerbaijan», En.Apa.Az, 2017, http://en.apa.az/azerbaijan_energy_and_industry/despite-conflict-with-turkmenistan-iran-delivers-gas-to-azerbaijan.html.

197 «Turkmenistan Intends To Further Export Natural Gas To Iran», Azernews.Az, 2017, https://www.azernews.az/region/108299.html.

198 "Armenia Eyes Gas Supplies From Turkmenistan", Free Europe / Radio Liberty, 2017, https://www.azatutyun.am/a/28221994.html.

Iran–Turkmenistan gas pipeline, which is now under development and will be handed over in 2020. Armenia hopes that this will offer alternatives to the country, allowing a reduction in gas prices.[199] There were also talks on a swap of Turkmen gas through Iran–Azerbaijan to Georgia via offshore private companies to supply industrial plants in Georgia, however this never happened. Turkmen gas is very cheap, but there are technical constraints.[200]

5.5 Possibilities of Iranian gas exports to Georgia

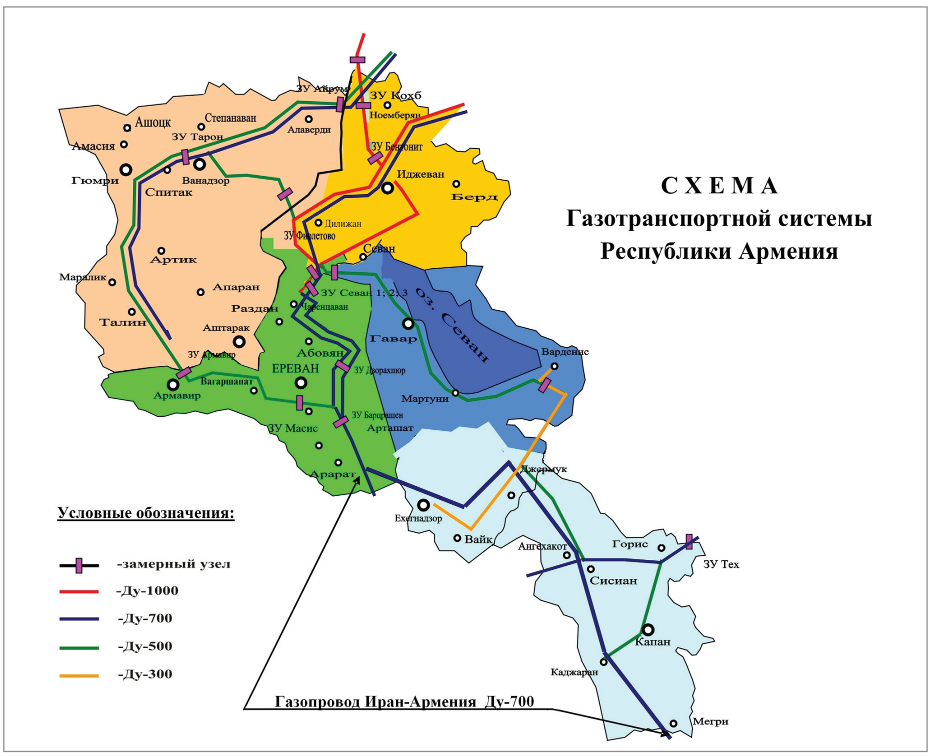
Since Georgia does not share a common border with Iran, the country should count on either Armenia or Azerbaijan for the transit of gas. As Armenia is isolated from most regional energy projects because of its occupation of Azerbaijan's territories, it will be vital for Armenia to involve itself in new projects. Georgia could use the existing IAGP and NSGP to increase and diversify its gas imports. The current annual throughput capacity of the IAGP stands at around 1.1 bcm/a (to be expanded up to 2.3 bcm/a by 2019), however, Armenia currently imports only about 300–500 mcm/a of gas from Iran.[201] The NSGP from Russia through Georgia to Armenia can deliver 12 bcm of gas to Armenia at its maximum capacity,[202] however, the country uses only 2.2 bcm/a of the pipeline's capacity. By pushing the full capacity of the IAGP and with a reverse supply from the NSGP, Georgia could receive Iranian gas through Armenia.

However the limited capacity of the IAGP, as well as Gazprom's purchase of a 40 km section of the IAGP, makes the transportation of Iranian gas through Armenia to Georgia somewhat problematic.[203] Russia's Gazprom had earlier pressured Armenia not to enhance the diameter of the IAGP, which hampered the possibility of exporting larger amounts of Iranian gas to Georgia.[204] The current diameter of the pipeline is too narrow to permit export of large volumes of Iranian gas to Armenia and their transit onwards. This renders Armenia's opportunities to buy large volumes of gas from Iran without Gazprom's agreement uncertain, both in terms of political and technical obstacles.[205] Moreover, the NSGP is used for domestic consumption in Armenia, thus making it available in reverse-flow for Iranian to gas to supply Georgia could deprive Armenia of Rus-

199 "Iran-Turkmenistan natural gas cooperation plan strategically promising", Tert.am, 2017, http://www.tert.am/en/news/2017/01/11/armen-manvelyan/2245090
200 Interview with an official (4) of GOGC in Georgia.
201 «Энергетическая дипломатия на Южном Кавказе: взгляд из Армении», Sever Yug, March 2016, pcsu.ru/энергетическая-дипломатия-на-южном-к
202 See official website of Georgian Oil and Gas Corporation, http://www.gogc.ge/en/gas-transportation
203 "Possible strengthening of Russia-Iran ties likely to bring Armenia into the equation", ArmeniaNow.com, November 2015, www.armenianow.com/economy/67740/armenia_iran_cooperation_russia_georgia_gas_azerbaijan
204 John Roberts, "From Feast to Famine in Azerbaijan", Natural Gas Europe, February 2016, www.naturalgaseurope.com/azerbaijan-caucasus-gas-georgia-russia-gazprom
205 Hakob Badalyan, "Armenian-Iranian Breakthrough: What Will Come Out of This?", Lragir.am, 2017, http://www.lragir.am/index/eng/0/comments/view/36470

sian gas supply. However, Gazprom has recently said that it plans to construct a new compressor station at the Abovyanskoye underground gas storage facility along with gas trunklines inside Armenia, as well as overhauling the country's gas transmission/distribution infrastructure,[206] although without detailing where exactly the overhaul will be conducted. It is also not excluded that Gazprom-Armenia can seek a share in the Energaimpex company, which is currently 100 percent state-owned.[207]

Map 4: Gas transportation system of Armenia



Source: armenia.gazprom.ru

Moreover, the IAGP does not extend to the Armenia–Georgia border; therefore, it is necessary to interconnect it to the NSGP passing through Georgia by constructing new extensions, which requires at least moderate financing. Iran's pre-

206 "Gazprom To Construct New Compressor Station, Trunklines In Armenia", New Europe, 2017, https://www.neweurope.eu/article/gazprom-construct-new-compressor-station-trunklines-armenia/.
207 Badalyan, "Armenian-Iranian Breakthrough…", *op.cit.*

vious plans to construct a new pipeline through Armenia to Georgia and further to Europe for natural gas export are doomed to deadlock because of Gazprom's ownership of Armenia's entire energy sector[208] and the impacts of sanctions on Iran. The small gas consumption of Georgia does not economically justify the construction of a new pipeline from Meghri to Kvemo-Kartli, unless Iran prioritizes delivering natural gas to Europe through this pipeline. However, the diameter and throughput capacity of pipeline would allow pumping only 6–7 bcm/a of gas, which is not a significant amount for Europe.[209] Given Georgia's limited gas consumption, neither Iran nor Georgia would be willing to invest in such infrastructure merely to bring 300–400 mcm/d of gas to Georgia. It would not be a cost-effective project. Even if it happens, Georgia will be dependent on Gazprom-operated pipelines in Armenia to import the Iranian gas.[210]

The lack of interconnection with adequate capacity between the two pipelines in Armenia, as well as the lack of will to invest therein and the obscurity regarding reverse flow from the NSGP renders both options unlikely. Even if there were a reverse flow capability and territorial opportunity for transit of Iran's gas to Georgia and to Europe through Armenia, Gazprom, which owns Armenia's entire gas distribution network, would not welcome this option as it will hamper Russian gas flows to Armenia. Moreover, the isolated status of Armenia is in Russia's interests, as it makes former more dependent on the latter.[211] After strengthening its position in Georgia's energy sector, Russia can prevent the transit of Iranian gas via Armenia to Georgia.

Moreover, the price of Iranian gas through Armenian territories would double with the transit fee, which would increase the gas price for Georgia. For instance, Turkey has been paying \$418/1000 m^3 for natural gas from Russia and \$487/1000 m^3 for gas from Iran.[212] In contrast, Azerbaijani gas goes to Georgia without a transit country and at lower price (because of geographical proximity) that either Iran or Russia would sell at. Mariam Valishvili stated that, buying Iranian gas at this stage was not commercially viable for Georgia as it is more expensive than Azerbaijani and Russian gas[213], but some type of energy swap

208 Eric Eissler, "Regional Energy Security: Turkey's Ambition to Become a Regional Energy Hub", Research Turkey, September 2012, researchturkey.org/regional-energy-security-in-georgia-azerbaijan-and-turkey-is-vital-for-turkeys-ambition-to-become-a-regional-energy-hub/

209 "Iranian gas for Georgia will cement Yerevan-Tbilisi ties", Armenian Centre For Society Research, January 2016, www.acsr.am/eng/articles/iranian-gas-for-georgia-will-cement-yerevan-tbilisi-ties/

210 Giorgi Lomsadze, "Georgia Struggles to Explain Why It's Dating Gazprom", Eurasianet.org, January 2016, www.eurasianet.org/node/76776

211 "Иранский план Саргсяна вызвал гнев Путина", Haqqin.az, November 2015, haqqin.az/news/56237

212 "Figures Say Iran Has Some Of The Highest Gas Prices & Transit Fees", Naturalgasworld.Com, 2015, https://www.naturalgasworld.com/iran-highest-gas-price-transit-fee-26366.

213 «Иранский Газ Дороже, Чем Азербайджанский Или Российский – Замминистра Энергетики», Caspianbarrel.Org, 2016, http://caspianbarrel.org/az/2016/02/iranskij-gaz-dorozhe-chem-azerbajdzhans/.

arrangements are not ruled out, though it is a long-term perspective.[214] There is no commercial rationale for importing Iranian gas to Georgia, because it is very costly and if it was feasible then Georgia could make a market assessment for that, a GOGC official confirmed.[215] Kaladze also said that, "we can talk about the purchase of Iranian gas in the future because of [its] non-competitive price."[216]

Although Georgia has not yet studied the possibilities for swap operations through Armenia and Azerbaijan, according to an official from the MoE of Georgia, a swap through Armenia is possible only for supply of small volume of gas.[217] A swap deal for Iran's gas export to Georgia might be realized with Russia's assistance[218] and the scheme would be as follows: Iran supplies a certain additional volume of gas to Armenia and Gazprom Export supplies the same additional volume to Georgia via NSGP, or from Armenia to Georgia through Armenia's domestic interconnectors owned by Gazprom-Armenia. In this case, Georgia would get an additional amount of Russian gas, but it would be called "Iranian gas."[219] This means that when Iran initiates a gas swap to Georgia, then Gazprom will take Iranian gas for Armenia coming via the IAGP and supply an equal quantity of gas to Georgia via NSGP. This also means that both Armenian and Georgian companies will be dependent on Gazprom for any delivery of additional Iranian gas to either Armenia or Georgia, since Gazprom owns Armenia's entire gas distribution system.[220] Otherwise, additional Russian gas exports to Georgia, without branding as a "swap deal," would trigger a public reaction in the country again, as it has already been observed in previous years. Therefore, the temporary gas export reported by Panarmenian.net (sub-chapter 5.2) could be regarded in the context of a possible "swap operation."

Another aim of a swap operation could be additional Russian gas supply to Georgia (as Iranian gas), substituted by having Iranian gas (as Russian gas) transported as LNG from the Persian Gulf. Russian energy minister Aleksandr Novak earlier reported that Russia and Iran were discussing natural gas swap operations. In this way, Russia can also deliver gas to the North of Iran through Azerbaijan via Mozdok–Makhachkala–Gazimagomed and Gazimagomed–Astara–Bind–Biand pipelines (GABB) and, in exchange, have LNG transported

214 "Georgian Energy Minister Visits Iran", Civil.ge, February 2016, civil.ge/eng/article.php?id=28984
215 Interview with official (3) of GOGC in Georgia.
216 «Грузия не желает покупать дорогой иранский газ - Каха Каладзе», Gruziya Online, February 2016, www.apsny.ge/2016/eco/1456791128.php
217 Interview with an official (4) of GOGC in Georgia.
218 "Iran to export Russian gas to Georgia via Armenia", The Great Middle East, 2017, http://en.thegreatmiddleeast.com/2016/07/iran-to-export-russian-gas-to-georgia-via-armenia/
219 «Российский Газ В Армению Через Иран - Комментарии Экспертов», Haqqin.Az, 2016, https://haqqin.az/news/61935.
220 Badalyan, "Armenian-Iranian Breakthrough…", *op.cit.*

to Asian countries from the south of the country. The capacity of the GABB pipeline (10 bcm/a) is substantially greater than the current throughput capacity of NSGP (2 bcm/a) and IAGP.[221]

Import of Iranian gas by Georgia is also possible through a trilateral swap operation via Astara *rayon* of Azerbaijan on the border with Iran.[222] Since there is an operational infrastructure on the ground with potentially scalable capacity, Iranian gas could easily be delivered to Georgia via Azerbaijan. Iranian gas would be pumped to Azerbaijan through the GABB pipeline in a reverse flow and injected into the South Caucasus Pipeline in Azerbaijan. Unlike Armenia, there is an interconnector and transport pipeline (GABB) with appropriate capacity in Azerbaijan. By linking the Iran–Azerbaijan pipeline with SCP, Iran could transfer its gas to Georgia via Azerbaijan.[223] Moreover, when Iran has surplus gas due to consumption and production mismatch in summer periods, the country can store its gas surplus in the underground gas storage (UGS) facilities of Azerbaijan. This gas can be supplied to Georgia during winter, when they experience gas shortages. Earlier, Iran and Azerbaijan's SOCAR were negotiating on storing Iranian gas in Azerbaijan's UGS.[224]

221 «Новый газовый план России: "Газпром" может дойти до Персидского залива», Caspian Barrel, October 2015, caspianbarrel.org/?p=35598

222 Interview with official (1) of GOGC in Georgia.

223 «В грузинском направлении политики АР возможно смещение акцентов», Ru.sputnik.az, November 2015, https://ru.sputnik.az/expert/20151103/402589180.html

224 Ilgar Gurbanov, "Russia Pushes 'Gas Swap' Plans With Iran Amidst Azerbaijan-Iran Gas Talks", The Jamestown Foundation, 2017, https://jamestown.org/program/russia-pushes-gas-swap-plans-with-iran-amidst-azerbaijan-iran-gas-talks/#.V9zjqB6LSUl.

CONCLUSION

Although Georgia enjoys an important geographical position and transit-country status, the country's gas-poor profile rendered it strongly dependent on external sources, mainly from Azerbaijan. This dependence also created a favorable relationship and strategic interdependence between the two countries. The gradually increasing gas demand and the seasonal consumption imbalance yielded unscheduled challenges for the country which need to be addressed through diversification of supply, rehabilitation of dated pipelines, and construction of underground gas storage (UGS) facilities. The UGS will bolster Georgia's long-term energy security in terms of mitigating the potential hurdles related to gas shortages during peak demand in winter.

Although Azerbaijan remains the top gas supplier for Georgia, the latter is also seeking to bring alternative gas sources, including Russia and Iran, to the country. However, it is believed that renewed gas supply from Russia to Georgia would have political repercussions (in respect of Ukraine and Armenia) for the country's energy security and increase its previous gas dependence on Gazprom. Although Georgia's gas consumption is not huge and subsequently Gazprom's market share will not be that significant, nevertheless, the country would eventually be forced to comply with Russia-set contract terms. Meanwhile, it is not clear yet what Russia's future gas prices will be for commercial entities or the social sector, or whether they will be lower than those of Azerbaijan. The new contact between Georgia and Gazprom on monetization of the gas transit service will be unlikely to affect Azerbaijan's market share in a negative way, even though the deal yields inferior economic and material gains for Georgia in the short to medium term. With the new transit deal, Georgia has less opportunity to benefit from the tariff in currency, compared to the previous tariff in commodity. However, concerning the new transit contract, the Georgian government had its particular reasons stemming from the country's international obligations, the transit status concerning relations with Armenia, the liberalized commercial sector allowing private entities to buy gas independently, the contractual margins of Azerbaijani gas, etc.

On the other hand, Azerbaijan will, for the next decade, remain a reliable gas supplier, while Georgia will continue to benefit from SOCAR's presence in its energy sector premised on the company's lower prices for the social gas sector, its tax contribution to the Georgian state budget and future gas supplies (once the SGC becomes operational). Nor does Azerbaijan's gas supply to Georgia imply any political enforcement. This requires an accurate reconsideration and a more prudent policy from the Georgian side concerning diversification issues, without unconsidered political maneuvers, given the geopolitical situation in the

South Caucasus. The majority of Azerbaijan's strategic projects, including oil and gas pipelines, pass through Georgian territory, thus enhancing the strategic significance of Georgia, as well as strengthening the trilateral relations between Azerbaijan, Georgia and Turkey. With the new discount in gas prices offered by SOCAR and the increasing volumes of Azerbaijani gas, Georgia will be able to meet its growing gas demand. With the completion of the SD2 project by 2019, Georgia is expected to fill the existing gap in gas supplies.

Moreover, Armenia attaches high expectations towards the possible trilateral energy talks between Iran–Armenia–Georgia, which will be a long-awaited blessing for the country. Given its longstanding isolation by both Turkey and Azerbaijan due to Armenia's occupation of Azerbaijan's territories, hosting Iran's gas transportation through its territories would grant Armenia "transit country" status. Although, from political and technical perspectives, there is less prospect for larger gas exports from Iran to Georgia via Armenia, Yerevan is quite active in this axis to carve out a transit role for itself in order to alleviate the repercussions of its long-running isolation in the region.

The dominant role of Russia's Gazprom (sole owner of Armenia's entire natural gas distribution system and facilities) in Armenia's energy sector is a noteworthy issue in this context. Gazprom-Armenia will not welcome the larger volumes of Iran's gas exports to Georgia via Armenia's Russian-owned infrastructure. This would hamper Russian gas flows to Armenia; open an alternative path for Iran's possible gas export to Europe; and strengthen Iran's position in the Armenian gas market, playing into the hands of Armenia in terms of political leverage.

Furthermore, the lack of technical opportunities, i.e., the absence of interconnections with adequate capacity in Armenia, demonstrates the lower opportunity for Georgia to receive larger amounts of Iranian gas through Armenia in the future. In contrast, there is operational infrastructure in Azerbaijan that can receive Iranian gas in a reverse flow and deliver it towards Georgia. However, the reported delivery of a small of amount of natural gas to Georgia through Armenia in the first half of 2016 without any media coverage attests to Iran's hidden determination to go forward beyond the trial agreements, although Iran would be more interested in delivering its gas in huge volumes to Europe through Turkey (the most optimal way) or as LNG to Asia's lucrative markets. On the other hand, the purchase of large volumes of Iranian gas by Georgia is now unlikely due to high price of Iranian gas, regardless of whether it is supplied through pipeline or swap operations. Therefore, all these factors diminish the likelihood of Georgia receiving huge amounts of Iranian gas through Armenia via pipelines in the near future.

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GAS DIVERSIFICATION POLICY OF GEORGIA

ROLE OF EXTERNAL ACTORS - AZERBAIJAN, RUSSIA AND IRAN

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