



On the Agreement between Gasprom-Export and Georgian Gas Transport Company
the New Terms of Russian Gas Transit to Armenia

Liana Jervalidze, Analyst on Energy
Security and Transit

The Orbelaini Center for Advanced
Energy and Security Studies
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Georgia's Gas Transport Company and Gasprom Export have signed a two year agreement on Russian gas transit to Armenia. Unlike previous agreement, the new agreement provides for step by step monetization of gas transportation service. Although the terms of the new transit agreement are financially less profitable for Georgia, we assume, they are in compliance with international standards. In addition, the new transit agreement endangers neither strategic partnership with Azerbaijan and Socar, nor the development of Southern Gas Corridor.

As a result of long and difficult negotiations the Ministry of Energy of Georgia has reached a two year agreement with Gasprom Export on the monetization of Russian gas transit to Armenia. The agreement is signed for two years and provides for step by step monetization of Russian gas transit service across Georgia. The Agreement is concluded between Gasprom Export and Georgian Gas Transport Company.

According to the Ministry of Energy of Georgia the first year of the contract Georgia will receive 10% of Russian gas transported to Armenia in kind for the first 1 bln m3 (out of about 2 bln m3 of Russian gas supplied to Armenia per annum). The transportation service of another 1 bln m3 of Russian gas will be covered by Gasprom Export in currency according to existing standards. Starting from 2018, the second year of the contract, gas transport service will entirely be subject to monetization according to existing standards.

Georgia's north/south gas pipeline which has been used for Russian gas supply to Armenia is 221 km. Through monetization scheme Georgia will not be able to buy as much gas as it used to receive under former contract which provided for 10% off takes of transited gas as a fee for transportation service rendered (that made about 200 mln m3 per annum). Thus, Georgia shall have to buy additional volumes of gas under commercial terms to balance the demand on its social gas market that will make it increasingly difficult to maintain existing tariffs for household consumers and power generation.

24 Mosashvili Str., 0162, Tbilisi, Georgia

0162, თბილისი, მოსაშვილის ქ. 24

Tel.: +995 32 2 91 20 40

Fax: +995 32 2 91 11 63

E-mail: psi@caucasus.net

www.psi.ge

Georgia's gas market: *in 2016 Georgia consumed 2,422 bln m3 of gas. Georgia's gas market has two sectors: commercial and social sectors. The commercial gas market (in 2016 –about 1 bln m3) is totally liberalized and consumers are free to buy gas wherever they find under the best terms they can find in the region. The so called social gas market comprises household gas consumption and power generation (in 2016 -1,422 bln m3); The consumption of social gas sector used to be partially covered by contracts with Shah Deniz Consortium (optional and supplemental gas- about 700 mln m3 per annum) and 10% of in kind gas for Russian gas transit to Armenia (about 200 mln m3 per annum). So far this 900 mln m3 per annum transit gas allows the country not to increase tariffs for social consumers. And above 200 mln m3 per annum of gas received for Russian gas transit to Armenia has been crucial for maintaining low tariffs for years. Apart from 200 mln m3 of gas received as in kind payment for Russian gas transit to Armenia, or the entire 2,2 bln m3 of gas for social and commercial consumers is supplied by Shakh Deniz Consortium and Socar the Azerbaijani Oil and Gas Company under long term contracts until 2025-2028.*

Obviously old gas transit contract terms effective until 2017 had been more profitable for Georgia than the new agreement providing for monetization of transportation service that was signed in January 2017. Some experts and political groups in Georgia raise questions why the Ministry failed to reach an agreement with Gasprom Export on old terms that provided for in kind payment for transportation service rendered. They argue that Georgia has a very strong position vis a vis Gasprom Export – the later has no other option to supply its strategic partner Armenia than to use Georgian gas network- and the ministry failed to use this leverage in negotiations with the Russian gas giant.

They also claim that the previous government managed to preserve profitable for Georgia terms in the transit contracts even in 2006 and 2008, the worst years of Russia –Georgia standoff and blame the ministry for betraying the interests of the country. In addition, they claim this contract endangers the interests of Georgia's major and strategic gas supplier Socar, the Azerbaijani Oil and Gas Company that holds almost 88% of the market.

Is the new contract so bad and did the Ministry on Energy of Georgia have much room for maneuvering in negotiations with Gasrom Export for maintaining 10% in kind payment for Russian gas transit to Armenia, avoiding the monetization of the transit service?

Below we try to answer these questions from independent expert standpoint:

In our opinion the new contract isn't as bad as the opponents claim:

- It doesn't contain take-or-pay and use-or-pay terms that are usually incorporated in contracts with Gasprom. Georgia has the right to buy gas from Gasprom Export when needed, in volumes needed at \$185 per thousand m3, if and when Socar fails to meet winter peak demand in Georgia. So far Gasprom doesn't get access to Georgia's downstream and retail market and Socar remains the main supplier of gas within its production and supply capacity.

Did the ministry have much room for maneuvering in negotiations with Gasrom Export for maintaining 10% in kind gas payment for Russian gas transit to Armenia?

In our opinion the Ministry did have limited room for maneuvering for the following reasons:

- Agreements are reached through mutual concessions, without concession on the part of Gasprom Export the Ministry wouldn't get any contract at all, as the previous contract had expired in December 2016.
- Georgia needs gas to meet winter peak demand when Socar if and when fails to supply necessary volumes first: due to technical limitations of Azerbaijan-Georgia old Soviet gas pipeline and second: to falling gas production and limited export volumes in Azerbaijan until 2019 when Shakh Deniz 2 is expected to be brought on stream, and 2022 when Absheron field is expected to be brought on stream. Georgia had been using 200 mln m³ of gas received in kind for Russian gas transit to Armenia as a cushion gas during winter peak demand. Georgia may need to buy some gas from Gasprom Export under commercial terms until gas production recovers in Azerbaijan.
- Georgia's ability to buy gas from other suppliers than Socar and Gasprom is limited due to infrastructure limitations (no third party access provided in Gasprom's gas export network) and geopolitical difficulties ravaging the region. Theoretically Georgia could get gas from:
 1. Turkmenistan, however this is beyond the will of just the Georgian government, Russia and Iran remain opposed to Trans Caspian gas pipeline until the issue of the status of Caspian is resolved
 2. From Iran through Iran-Armania gas pipeline if it expanded or a new gas pipe in the same corridor built, however in current circumstances it is very unlikely Iran would challenge Gasprom **in the area of its core interest in South Caucasus**. Again Georgia may need to buy some gas under commercial terms for meeting winter peak demand.
- Georgia couldn't refuse signing the transit agreement with Gasprom Export under new terms and continue illegal off-takes of Russian gas transported to Armenia for meeting winter peak demand when Socar failed to supply and other supplies (Iran, Turkmenistan) unavailable. First, with time, Gasprom Export would take the case of illegal off-take to arbitration and would most probably win it, and second this would inevitably damage Georgia's image as a reliable transit partner.
- Gasprom Export and Armenian Gas Company could agree to identify Georgia /Russian border as a sale's point for Russian gas transit to Armenia instead of Georgia-Armenia border (currently). In this case Georgia shall have to negotiate Russian gas transit terms with an Armenian partner(unlike Russia Armenia is a member of the Energy Charter), not with Gasprom Export, under the Energy Charter terms and conditions where transit tariff calculations are set and dispute settlement mechanism is in place and in practice.

And the most importantly Georgia couldn't block gas supplies to Armenia, as some Georgian "experts" and politicians claimed, because of its dispute on gas transit terms with Gasprom Export. First, Georgia has undertaken strong commitments under its membership to international platforms (Energy Charter, WTO, and EU Association Agreement) to ensure uninterrupted and unhindered transit of goods and commodities across its territory. Through blocking the Russian gas transit to Armenia Georgia would default on its commitments and potentially be challenged by Gasprom Export in the court. And second, this would undermine good neighborly relations with Armenia and the image of Georgia as a reliable transit partner.

Although the terms of new Agreement on Russian Gas transit to Armenia are financially less profitable for Georgia, we assume they are up to date and in compliance with international standards. In addition, the new transit agreement endangers neither strategic partnership with Azerbaijan and Socar, nor the development of Southern Gas Corridor.