



World Experience for Georgia

Legal Aspects of Georgia –GAZPROM EXPORT Transit Agreement

Introduction

The Transit of Russian gas to Armenia, through the territory of Georgia, has been carried out since the commissioning of North-South Caucasus main gas pipeline in 1991. The Transit price for Georgia, defined as in-kind payment (10% of transited gas), was effective including 2016. However, since 2017 the Transit conditions changed following the new agreement between the Ministry of Energy of Georgia and “Gazprom Export”. The Transit fee under this new agreement was defined as monetary compensation, which is undisclosed and declared as a “commercial secret” by Georgian authorities. Officials indicate that Georgia had to agree to worsened conditions though it is difficult to estimate the value of economic loss.

The issue of Russia-Georgia energy transit relations and this particular agreement require in-depth and comprehensive analysis including geopolitical, technical, economic, legal, and security aspects, as well considerations of procedural transparency and public communication. Here we present only our initial assessment of certain legal aspects, which we consider for future relations with Gazprom.¹

Official Arguments on Georgia-Gazprom new Transit Agreement

According to official statements, the issue of changing the transit arrangement from existing in-kind payment to monetary compensation was initiated by Russian side. Georgian officials and some experts explain that the change of transit conditions was inevitable due to the following reasons:

1. Georgia’s international commitments under Energy Charter and World Trade Organization (WTO), requiring monetary compensation of Transit service “commensurate with” actual expenses entailed;
2. Commitments under the EU-Georgia “Association Agreement” and the Energy Community Accession Protocol;

¹ *This assessment of legal aspects is largely based on the research prepared by WEG expert –Tamar Tsurtsunia “Gas Transit through Georgia in the light of Energy Charter and Energy Community provisions” published by Energy Charter Secretariat in 2015*

Source: <http://www.energycharter.org/what-we-do/publications/gas-transit-through-georgia-in-the-light-of-energy-charter-and-energy-community-provisions/>

3. The risk of legal dispute on Transit between Armenia and Georgia (Dispute Panel request by Armenia), taking into consideration Georgia's international commitments on Transit;
4. Georgia's interest in maintaining the status of a reliable and predictable Transit country.

Below we analyze the above arguments in more detail.

1. Requirements of Monetary Compensation for Russian Gas Transit in the Context of International Commitments

1.1 Regulation of Transit Within the International Multilateral Legal Framework

International transit of energy goods, is regulated by General Agreement on Tariffs and Trade (GATT), Article V and by the Energy Charter treaty, Article 7. Considering that Georgia together with Russia are members of "World Trade Organization", (the legal successor of GATT), GATT article V shall apply to Transit. GATT Article V requires the WTO members to ensure uninterrupted Transit of energy goods. The charge for transit shall be reasonable, having regard to the conditions of the transit. However, the GATT Articles do not specify what kind of fee shall be applied (in kind, cash and etc).

Within the WTO framework the in-kind payment can exist provided that the service recipient agrees that the price for Transit commensurate with the actual (capital, operational, administrative, etc.) costs entailed which is a matter of agreement between the parties.²

Therefore, since GATT articles do not specify the form of compensation, WTO requirements cannot be considered as the compelling reason for modification of existing Transit arrangement between Georgia and "Gazprom Export" and shifting to monetary compensation from in-kind payment.

1.2 International Legal Framework on Transit in Relation with Russia

While considering the issue of Transit arrangements with Russia, under International Legal Framework, one has to take into account that Russia itself does not recognize principles of international law on Transit (envisaged under WTO rules³) on its own territory. Russia's withdrawal from the Energy Charter Treaty (signed in 1994 but never ratified) in 2009 is a clear indication of this policy

Indeed, the main reason of Russia's withdrawal from the Treaty was the requirement of free transit over its territory. Ratification of the Energy Charter Treaty would oblige Russia to allow the free and uninterrupted transit of natural gas from Central Asia (Kazakhstan, Uzbekistan and especially

² Examples of Transit compensation in the form of in-kind payment are gas supply to Italy from Algeria through the territory of Tunisia, or from Azerbaijan to Nakhichevan region through Iran, as well as, gas purchase (affordable price) agreement with SCP consortium, which was prepared by qualified international experts, based on international best practice.

³ E.g., recently Ukraine requested WTO Dispute Panel over Transit restrictions imposed by Russia on Ukrainian goods.

Turkmenistan) to Europe. This would deprive Russia of a monopoly power of buying the natural gas from Central Asian states and reselling to Europe at arbitrary prices. Thus, Russia would have to give up its political weapon, against its perceived interests.

Russia wanted to use the Energy Charter Treaty as the means to facilitate the Russian gas transit to Western markets over Eastern European countries. However, after Russian-Ukraine gas disputes Russia finally decided to withdraw from Energy Charter with the complaints that the latter could not solve the dispute with Ukraine.

While Russia does not observe the requirements of international multilateral framework on transit on its territory, it does not have strong legal grounds for imposing such a requirement on Georgia. Russia may continue to refer to GATT Article V for political manipulations towards neighboring countries, however, presumably will never use it for legal dispute as this would create a legal case and a precondition for recognizing international principles of transit on its own territory, which is allegedly not in Russia's current interest.

Georgia's own experience of transit relations with Russia provides another proof of Russia's unilateral policy with regards to transit. The previous attempts to import electricity (AES Telasi – early 2000-ies) or natural gas (Kazmunaigaz -after 2006) from Kazakhstan through Russian territory was impossible due to obstacles created by Russia.

Therefore, since Russia does not abide by international principles of Transit on its own territory, it has no solid legal grounds to require Georgia to apply these principles unilaterally. On the contrary, such requirement violates, the principles of reciprocity and equality of WTO member states.

2. Monetization Requirements of Russian gas Transit Fee under Georgia – EU Association Agreement and Energy Community membership

Under EU-Georgia Association Agreement and Energy Community membership, Georgia commits to bring the energy markets and trade related rules closer to EU/Energy Community legal framework. This requires that tariffs for transmission of natural gas shall be set through a cost based methodology by regulator.

The EU member states are obliged to use such a treatment in relation to transportation (Transit) of energy goods within the EU's single market having no internal borders. However, due to geographical isolation from EU/EnC markets, Georgia is unable to trade directly with the EU/Energy Community member states, as well as to receive a direct assistance (e.g. natural gas) from them in case of emergency. This circumstance has allowed to preserve the existing international gas transit agreements of Georgia and to define the conditions for implementation of European standards, under the above documents, taking into account country's interests.

As a result, the following conditions on the regulation of Transit are envisaged under Association Agreement and EnC Accession Protocol:

- ✓ Trade-related Energy Provisions (DCFTA) within the Association Agreement, signed between the EU and Georgia, covers Transit regulation issues. However, the commitments do not go beyond Georgia's international commitments under WTO/GATT 1994 and the Energy Charter Treaty.
- ✓ Under Georgia's accession Protocol to Energy Community Georgia is exempted from any additional obligations in relation to gas Transit through North-South (Russia-Georgia-Armenia) and East-West (Azerbaijan-Georgia-Turkey) pipelines.

As a result, EU-Georgia Association Agreement and Energy Community Accession Protocol do not contain specific requirement for North-South gas transit including the form of transit compensation.

3. The risk of Legal Dispute on Transit between Armenia and Georgia

The risk of a legal dispute on Transit, e.g. possible dispute Panel request by Armenia in view of Georgia's international commitments, has been named as one of the preconditions for the amendment of existing agreement with Gazprom. This argument, however, might be only relevant if Georgia attempted to disrupt the gas Transit to Armenia, which has never been intended.

A disagreement on Transit price between Georgia and Russia (Gazprom Export) could not become a reason of Georgia's termination of gas Transit to Armenia. On the contrary, Georgia was interested in preserving the gas flows as it would allow to continue receiving the (in kind) Transit fee as per existing conditions.

A disagreement on Transit price between Georgia and Russia (Gazprom Export) could not trigger a legal dispute between Georgia and Armenia. A legal dispute might arise only between the supplier (Russia) and the Transit service provider (Georgia), where it would be determined whether the Transit country (Georgia) had violated GATT requirements or supplier (Russia) requested unreasonable modification of existing conditions of Transit. Otherwise, it would be difficult to claim that Georgia violated international transit obligations towards Armenia.

Therefore, a disagreement on Transit price between Georgia and Russia could not become a reason of a legal dispute between Georgia and Armenia as Georgia has never intended or attempted to terminate gas delivery to Armenia.

4. Georgia's International Reputation of Reliable and Predictable Transit Country

Another justification brought up in support of new Transit arrangements with “Gazprom Export” is Georgia’s interest in maintaining its status as a reliable and predictable Transit partner country in the region. However, the confidentiality imposed on Transit conditions with “Gazprom Export” does not support such an intent. Indeed, WTO/GATT requirement of non-discriminatory treatment between WTO members implies the transparency of transit arrangements so that this information should be accessible to any interested party, as explained below:

- Energy Network service is a natural monopoly activity not a competitive business, therefore it should be regulated and not subject of commercial confidentiality;
- According to the principles of international law, Transit country, under WTO rules, has to offer equal conditions to any interested party and ensure Most-Favored-Nation treatment (MFN);
- Transparency of information is a pre-condition for observing the MFN principle. It ensures that any third party, interested in energy transit can be assured that it gets non-discriminatory, equitable and predictable treatment from transit provider Georgia.

Concealing the Transit price and conditions may be considered as an indication that Georgia might be willing to apply different treatment to different interested parties and thus pursue the internationally condemned Russia’s practice of using energy for political manipulations.

Transit price monetization, under confidentiality conditions, is not in line with Georgia’s aspiration of maintaining the status of a reliable and predictable international Transit country. On the contrary, it damages Georgia’s reputation, as it does not guarantee transparent and equitable conditions for potentially interested third parties.

Conclusions and Recommendations

The issues discussed above require a more comprehensive and in-depth legal analysis, however the following conclusions can still be made:

- Russia’s alleged demand towards Georgia to unilaterally observe the principles of International Legal Framework in relation to gas transit does not have solid legal grounds, as Russia does not recognize these framework on its own territory;
- Russia’s alleged demand for observance of international principles of energy Transit entitles Georgia to request the same treatment from Russia to provide similar transit conditions on Russian territory, in case of Georgia’s interest in importing gas from Central Asia;
- Without such a request the principles of reciprocity, equality and sovereignty are not observed during the negotiations, which creates undesirable precedent, a precondition for further concessions and submissions in future economic and political relations with Russia;
- Confidentiality of Transit terms does not conform to Georgia’s intention of being a reliable and predictable Transit partner and contradicts with WTO principles of providing the equal (MFN) treatment to any interested parties.

Therefore, it is necessary to start preparation for further negotiations with Russia in order to restore the reciprocity and equality in relation to Transit of energy goods between the parties. In particular:

- Preparation of future negotiations with Russia should be started timely, including in-depth analysis of legal issues and development of strategic scenarios, with engagement of international experts; as well as strengthening intergovernmental coordination and consultations with international partners;
- Georgia should require protection of reciprocity rights under the WTO by demanding equal treatment from Russia with respect to transit over its territory (potentially from Central Asia);
- The work should be started for disclosure of Transit conditions including raising this issue with “Gazprom Export” if needed.