

EFFECTS OF THE RUSSIA-UKRAINE WAR FOR GEORGIA'S ENERGY SECURITY IN THE SHORT-TERM PERSPECTIVE

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USAID-ის სამოქალაქო საზოგადოების ჩართულობის პროგრამა
USAID CIVIL SOCIETY ENGAGEMENT PROGRAM



World Experience for Georgia

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EXECUTIVE SUMMARY

Russia's invasion of Ukraine creates new geopolitical circumstances for Georgia and directly affects the prospects of its future development. The present publication outlines key challenges faced by Georgia's energy security in the short-term perspective. It also attempts to answer the questions accumulated in society about:

- ▶ Dependence on Russian imports with regards to electricity, natural gas, and oil;
- ▶ Enguri hydropower plant and energy supply of Abkhazia;
- ▶ Russian capital in the Georgian energy sector and consequences of sanctions;
- ▶ EU's energy policy towards Russia and how it affects Georgia's energy supply.

We believe that, **in the short-term, Russia's leverage against Georgia's energy security, both in terms of cutting off or threatening to cut off energy supply or using it for political blackmail, has not changed. However, import dependence on Russian electricity and natural gas is increasing and causes additional concern.**

The share of electricity imported by Georgia from Russia was 9.1% of total energy consumption in 2021. Given that Georgia can meet most of its electricity demand through domestic energy production (92% in 2021) and cross-border ties with other neighboring states (Azerbaijan Armenia, Turkiye), the dependence on electricity imports from Russia does not create critical short-term risks. **To maintain existing conditions as consumption grows, it is important to develop local sources to generate electricity.**

Up until 2019, the share of Russian natural gas in total consumption was no more than 8%. However, the demands on natural gas and electricity are drastically increasing, while some of the electricity consumed is generated by thermal power plants running on imported gas. As a result, there has been an increase in natural gas imports from Russia reaching 15% in 2021. Georgia imports natural gas mostly from Azerbaijan. At this stage, the effects of the Russian-Ukraine war on natural gas imported from Azerbaijan are minimal. Azerbaijan, as a strategic partner of Georgia, continues to supply gas in the usual mode. Georgia imports about 17% of total petroleum products from Russia (2021). In case of any import cut-offs, it is possible to balance the deficit with imports from other countries. **To prevent the increase in energy imports from Russia, Georgia needs its gas storage facility and petroleum refinery.**

The Russian capital is operating in the energy sector in Georgia, however, special regulations and oversight from the Regulatory body give sufficient protection to consumers against the consequences of current and potential sanctions imposed on Russian businesses. **If an action or situation is perceived as threatening to the state or public safety, which may result in shortages in electricity or gas production/supply, the licensing authority (Georgian National Energy and Water Supply Regulatory Commission – GNERC) has the power to file in court for appointment of a special manager in the licensee concerned.** The special manager will be empowered to enforce fulfillment of all license conditions.

In response to Russia's invasion of Ukraine, the EU has decided to expedite the move to renewable energy sources. The European Green Deal had already set the goal of reducing fossil fuel dependence by 2030 (European Commission, 2019), while according to the new REPower EU plan (European Commission, 2022), the EU's critical dependency on Russian fuel will be phased out before 2027. **The EU is planning to reduce its dependence on Russian gas imports by two-thirds in 2022.** The European Commission also notes that „**for Ukraine, Moldova, and Georgia, the EU stands ready to provide support to ensure reliable and sustainable energy**“ (European Commission, 2022).

Azerbaijan is viewed as a potential source for reducing the EU's dependence on Russian gas imports. However, the current production and infrastructure restrictions do not allow significant growth in EU imports (over 1 bcm). The increase of gas supplies from Azerbaijan to the EU is likely to also improve

Georgia's position towards Russian imports as it will provide the opportunity of purchasing more Azeri gas at the agreed price (5% of throughput).

The recent developments demonstrate the unreliability of Russia as a contracting party. Nevertheless, transparency and public access to contractual terms with Russia are crucial to protect public officials from potential tampering and temptations. **Relevant authorities in the energy sector should systematically assess existing and potential risks based on coordinated cooperation.**

INTRODUCTION

The Russia-Ukraine war is creating a new security environment for the EU as well as for the Caucasus region. The consequences of the war directly affect Georgia's future development.

When in 2005, Putin referred to the collapse of the Soviet Union as the „greatest geopolitical catastrophe of the 21st century“ (The Washington Post, 2005), Russia's imperialistic intentions toward former members of the Soviet Union became clear once again. Forms of hybrid warfare waged by Russia (Chivvis, 2017), including creating „frozen conflicts“ to thwart countries' Euro-Atlantic aspirations, engaging in military interventions, waging information warfare, and more, were identical across Ukraine, Moldova, and Georgia.

Amid the ongoing hostilities, it is difficult to estimate how Russia's energy policy will change toward neighboring countries. It is however important to analyze challenges that may arise in the short term and create corresponding safeguards. Amid the war, Georgia's dependence on Russian energy resources is often brought to the forefront and is often viewed as critical for Georgia, which mislead its population.

Georgia's energy consumption is increasing every year. Since 2000 the gross final energy consumption has increased by 90%. The transport sector is leading with 30% share, followed by the household sector (28%), industry (16%) and others. About 17% of the energy is consumed by occupied Abkhazia.

Georgia's energy production covers less than one-fourth of its energy demand (21.4% in 2019). Most of Georgia's domestic energy production (1.09 Mtoe in 2019) comes from hydro and biofuels/waste (0.768 Mtoe biofuels and 0.245 Mtoe waste). The energy mix is relatively diverse compared with other countries in the region. In 2019, natural gas was the first fuel in the energy mix (45.4%), followed by oil (27%), renewables (20.4%), and coal (4.7%) (IEA, 2021)

A part of the electricity consumed in Georgia (9% in 2021) and nearly 100% of natural gas and petroleum products are imported.¹ Energy resources are imported from neighboring countries, including the Russian Federation. Additionally, Russian companies or citizens own capital and assets in Georgia's energy sector.

This publication analyzes the effects of the Russia-Ukraine war on Georgia's energy security in the short-term perspective and attempts to answer questions that have accumulated in the society in the following areas:

- ▶ Dependence on Russian imports with regards to electricity, natural gas, and oil;
- ▶ Enguri hydropower plant and energy supply of Abkhazia Region;
- ▶ Russian capital in the Georgian energy sector and effects of sanctions;
- ▶ EU's energy policy towards Russia and how it affects Georgia's energy supply.

It is not the purpose of the publication to provide a comprehensive in-depth analysis of the war implications for Georgia's energy security. Such assessment will largely depend on its outcome and will require analysis of different scenarios.

¹ Based on the energy balance of Georgia.



DEPENDENCE ON IMPORTS FROM RUSSIA

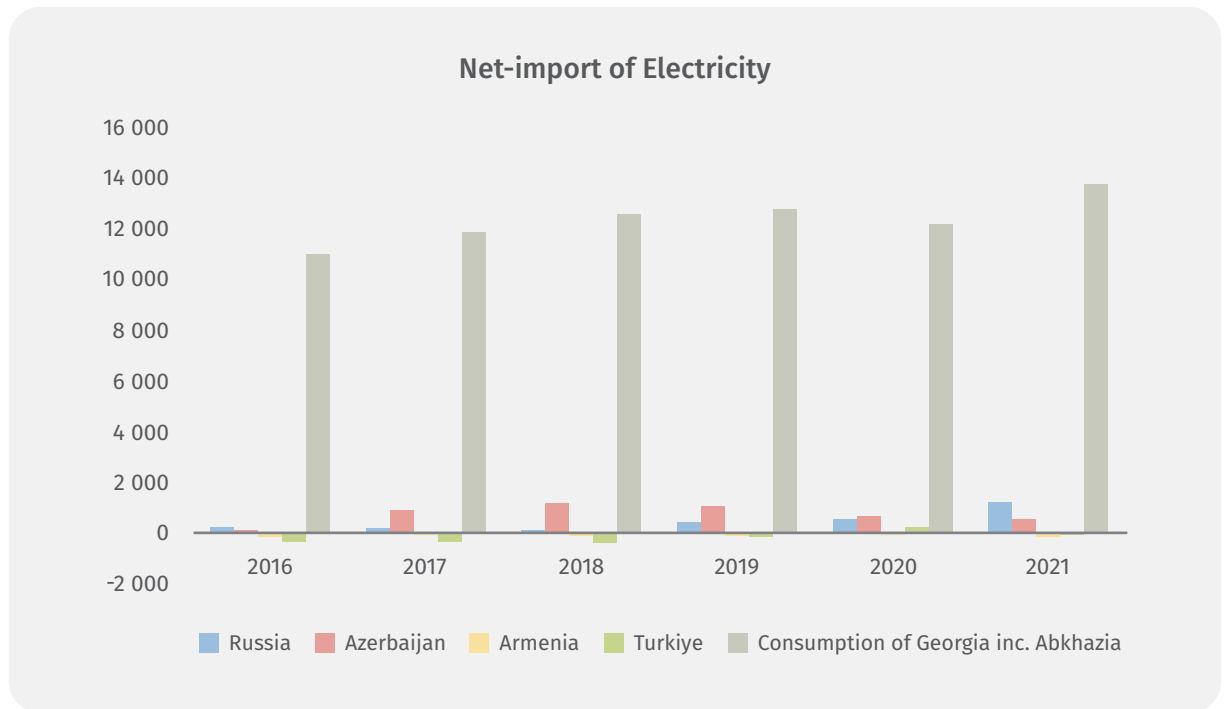
Georgia has various energy ties with Russia:

- ▶ Electricity imports, including imports for the occupied Abkhazia region;
- ▶ Synchronous operation with Russia's electric power grid;
- ▶ Transit of Russian electricity to Turkiye through Georgia;
- ▶ Natural gas imports for local consumers;
- ▶ Natural gas transit to Armenia through Georgia;
- ▶ Import of petroleum products;
- ▶ Presence of Russian capital in Georgia's energy sector.

Given that these components are interrelated, and they affect one other, safeguards need to be developed based on a systemic unified approach. First, we need to understand the dependencies created by each one of them.

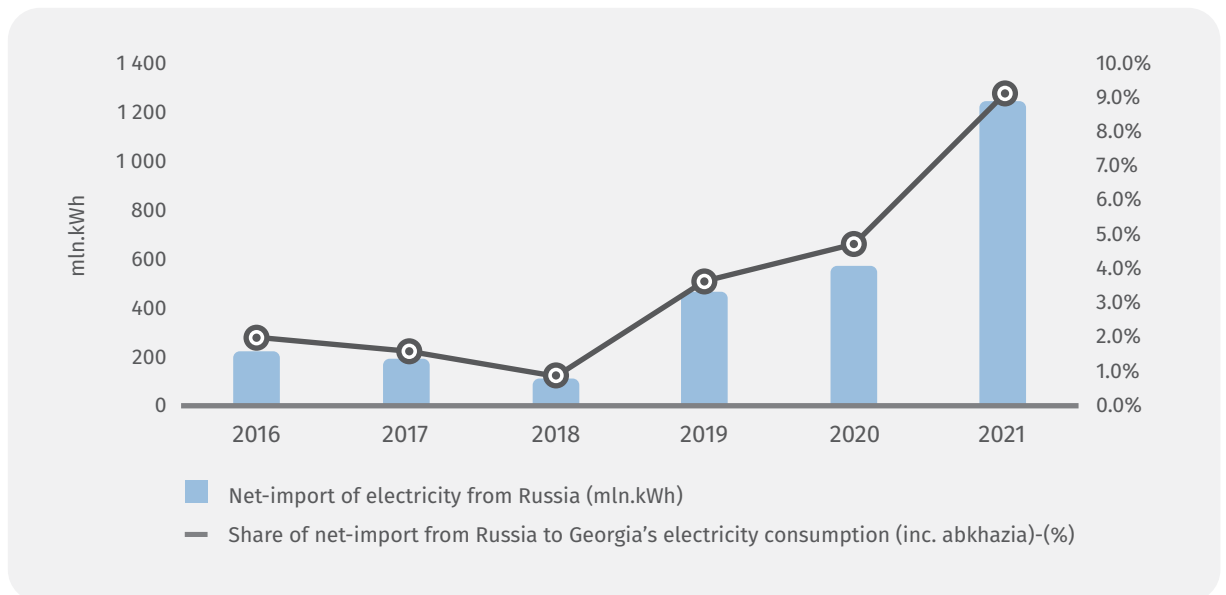
Electricity

Most of the electricity demand in Georgia is met by domestic hydropower (up to 70%) and thermal Power Plant (more than 20%) generation. Due to their seasonality, hydropower plants generate maximum energy in May-July (over 98%), while their output is at a minimum in December-February (46-53%). In winter, the demand is partially met by gas-fired thermal generation and import. Georgia's electricity system is interconnected with those of Azerbaijan, the Russian Federation, Turkiye, and Armenia. Cross-border trade and exchange allow Georgia to balance supply and demand. Due to rising domestic consumption country has been a net importer of electricity in recent years (IEA, 2020).



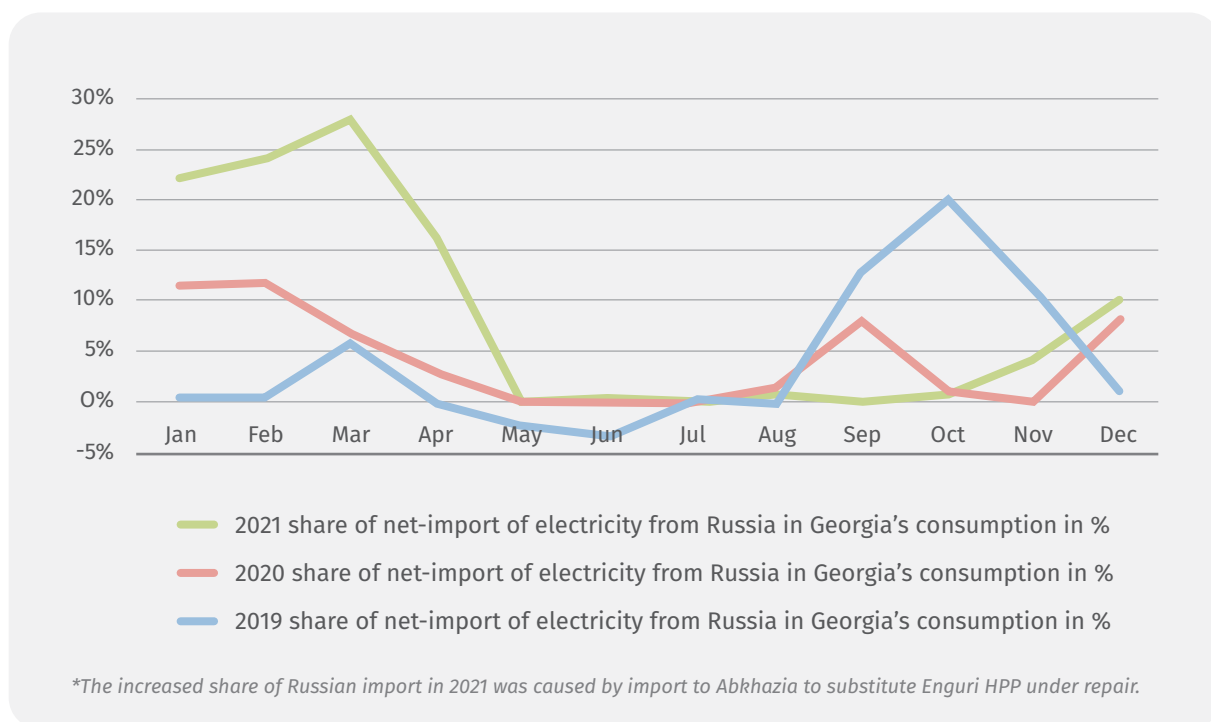
GRAPH 1: NET-IMPORT OF ELECTRICITY BY COUNTRIES

Electricity imports from Russia peaked in 2021 (1.245 TWh), reaching 9.1% of gross domestic consumption. A big part of the Russian electricity import goes to occupied Abkhazia. Prices of imported electricity vary by year. The graph below summarizes information about electricity imports from Russia over the last six years.



GRAPH 2: ELECTRICITY IMPORTS FROM RUSSIA

Russian import is highest in January-March and November- December. Share of net import of electricity from Russia in Georgia's consumption reaches 28% in March (2021). Which country Georgia imports electricity in a particular month depends on the price.



GRAPH 3: ELECTRICITY IMPORTS FROM RUSSIA

The data shows that **the annual share of net imports from Russia in the gross domestic consumption is moderate (up to 9% in 2021)** however electricity import from Russia is increasing.

A major share of the Russian electricity import goes to occupied Abkhazia which is part of Georgia's power grid. In general, the bulk of electricity consumption in Abkhazia (90% in 2020) is covered by Enguri and Vardnili hydropower plants, with the Russian share below 10%. 2021 was an exception when due to Enguri HPP rehabilitation the Russian share amounted to 34% of Abkhazia's annual consumption (0.992 TWh). As a result, the electricity imports from Russia to Georgia amounted to 1.2 TWh making it a top supplier. 80% of this import was used to supply Abkhazia.

In short term, Georgia can meet most of its demand for electricity through domestic production and cross-border trade with other states (Azerbaijan, Armenia, Turkiye). Therefore, the vulnerability to short-term interruptions from Russia is not critical. However, Because of the substantial rise in electricity demand and related deficit, there is a shortage of generation and new capacity will be even increasingly needed in coming years. In 2019, for the first time in Georgia's history, the electricity imports exceeded exports during the summer. Considering the new model of electricity market, which entails creating electric energy exchange, reservoir HPPs become especially important.

As for another factor, Georgia's electric power system is synchronized with the power systems of Russia and Azerbaijan. This helps to maintain the stable frequency and voltage on the grid, which is crucial for the quality of power supply to consumers. **It is unlikely that Russia will disconnect Georgia from its electric power system, as this will cause instability not only in Georgia's but also in Azerbaijan's power grid as well as Abkhazia.**

Amid the war, the power transmission systems of **Ukraine and Moldova have synchronized with Continental Europe's power systems (ENTSO-E)** (ENTSO-E, 2022) by disconnecting themselves from the unified power system of Russia and Belarus. This process was previously expected to take place by 2023 at the earliest. The first stage of testing Ukraine's power system in isolated mode from the power systems of Russia and Belarus, in preparation for synchronization with the European ENTSO-E was scheduled for February 24-26, 2022 (Ukraine Business News, 2022). However, the war strongly accelerated the process. Ukraine cut its power connection with Russia and Belarus on Feb. 24, the first day of the war. Since then, it has been able to keep its grid stable even as Russian troops invaded the country (Bloomberg, 2022).

Georgia's power system is not synchronized with the ENTSO-E, however Georgian State Electrosystem (GSE) is working to obtain the status of an observer in ENTSO-E like Turkiye. In 2018 GSE signed a

long-term bilateral Cooperation Agreement with ENTSO-E. This will allow the country to improve the local regulations, promote both professional and institutional capacity and long-term development prospects, increase the possibility of attracting investments and enhance energy cooperation with the EU (GSE, n.d.). the eventual switch to synchronization with ENTSOE will require significant time and investment over the next years.

Russia exports electricity to Turkiye through Georgia. In 2020, the transit lasted several months, and it amounted to a total of 463 GWh. The transit took place in March also (92 GWh) (GSE, 2022). The Government of Georgia (GoG) needs to decide whether to support Russia's trade over its territory in the future and make the conditions transparent.

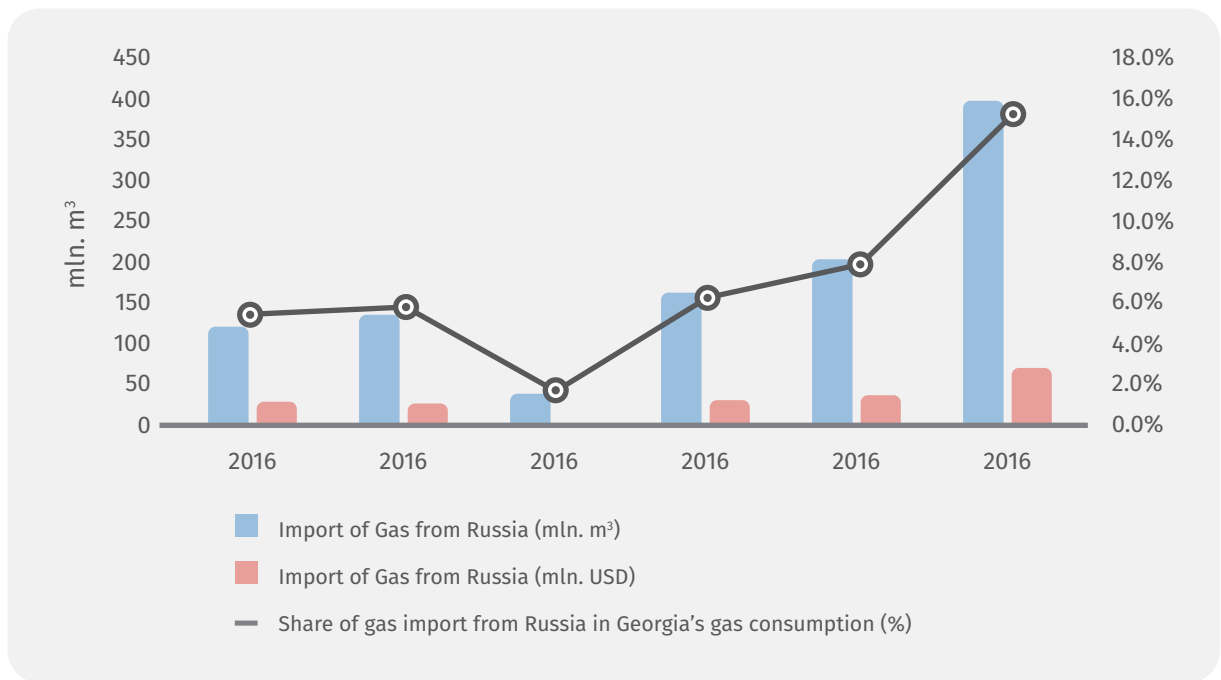
Natural gas

It is well-known that Russia is using gas for political purposes. After the 2003 Rose Revolution, Moscow soon began applying energy sanctions to Georgia. As with other defiant ex-Soviet states, Georgia was subjected to massive gas price increases. From 2004 to 2006 the price demanded by Gazprom increased almost 500 percent, from \$50 to \$235 per thousand cubic meters.

The winter of 2006 became an illustrative example of Russia using energy as a political weapon. After the sabotage of the two strings of the main gas pipeline (supplying Georgia and Armenia) and blowing up of the power transmission tower on Russian territory, on the coldest day of January 21, Georgia was totally cut off from (at that time vital) Russian energy supply, left without reserves and alternatives to experience cold and dark. Russia announced that both main gas lines to Georgia had been cut by bomb blasts, allegedly by Chechen separatists. Moreover, when after two weeks of energy blockade, through the efforts of Azerbaijan, it became possible to transit Russian gas through the Azerbaijan gas transportation system, Gazprom stopped supplying Azerbaijan as well (WEG, 2019) Use of energy supply as a political leverage continued until the South Caucasus Pipeline (SCP) became operational, significantly weakening the leverage for Russia. **Starting from 2007, Azerbaijan became the main supplier of gas for Georgia.**

Connection with Russia is limited to the North-South Main Gas Pipeline, which transits natural gas from Russia to Armenia. From 2017, the gas pipeline operator, Georgian Gas Transportation Company (GGTC) receives monetary compensation for the services rendered. **Gas transit fee is undisclosed and declared a commercial secret by the government.** Georgia can receive Russian gas through the same pipeline based on an agreement with Gazprom Export (GOGC, 2020). **In 2018-2020, import of natural gas from Russia to Georgia grew from 39 million m³ to 2014 million m³, which amounts to 7.6% of gas consumed in Georgia (see Graph 4). In 2021, this number increased to 15%.** Russian gas is primarily used by commercial sector in Georgia.

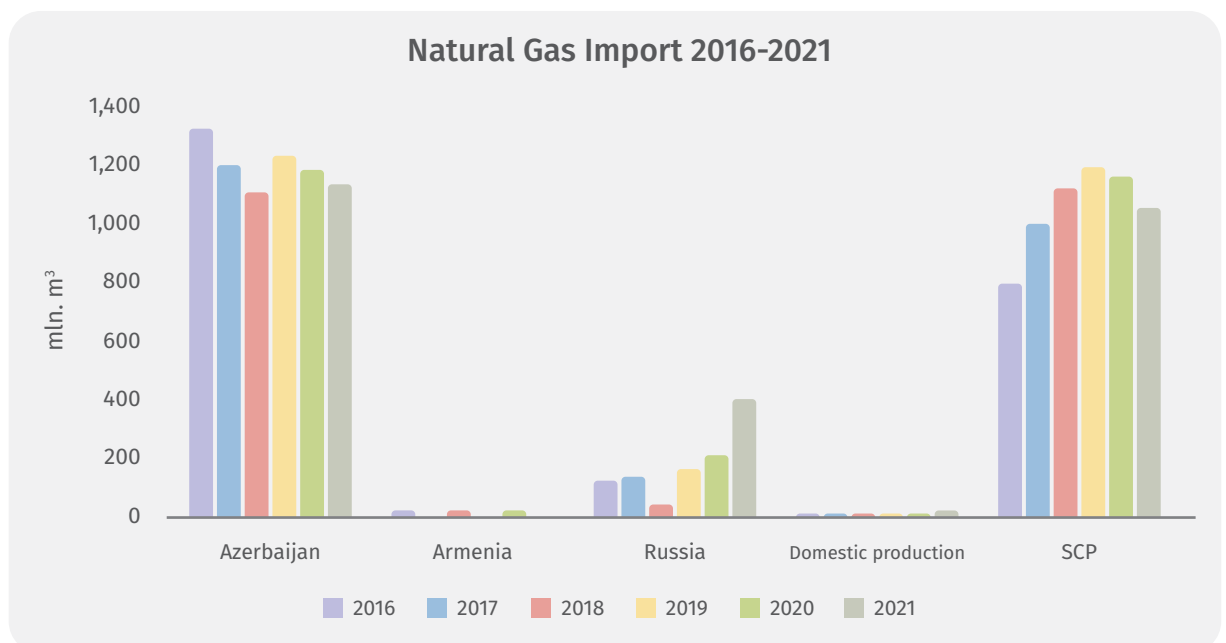
In current circumstances it is not likely that the supply of gas from Russia will be physically terminated, as this will also cause termination of gas supply to Armenia. Neither it will be a vital blow as it was back in 2006.



GRAPH 4: RUSSIAN GAS IMPORTS TO GEORGIA

Azerbaijan is the main gas supplier to local market. Georgia receives the gas from Azeri Shah-Deniz gas field, as so-called „optional“ and „supplemental“ gas purchase and sale contracts under the Host Government Agreement with Shah-deniz consortium. Volume of „optional“ gas is determined on an annual basis, allowing the purchase of up to 5% of throughput to Turkiye (until 2066) and additional 0.5bcm of gas (until 2026) for a fixed pre-determined price. (BP, 2006). In addition, the GoG has signed a (undisclosed) memorandum with SOCAR Gaz Export-Import to supply more natural gas until 2030.

The gas from SCP is purchased by the JSC Georgian Oil and Gas Corporation (GOGC), which has signed the corresponding contracts (GOGC, 2020). To provide affordable energy to households, the government's policy is to take advantage of the relatively inexpensive natural gas Georgia has access to as a transit country, and to supply this "social" gas to the residential sector and thermal power plants (TPPs) at considerable discount to market prices. The retail and wholesale gas prices are offered to the rest of the customers by SOCAR Gas publicly with unclear principles of their fixing.



GRAPH 5: SOURCES OF NATURAL GAS SUPPLY IN GEORGIA

Effects of the Russia-Ukraine war on supply of natural gas from Azerbaijan are minimal in the short-run, as Georgia's strategic partner Azerbaijan continues to supply Georgia with gas in the usual mode. However, the consumption of natural gas and electricity is increasing significantly (part of electricity consumed is generated by thermal power plants running on imported gas). **In recent years the gas demand exceeds the capacity of supply by SOCAR over Kazakh-Saguramo pipeline. As a result, natural gas imports from Russia have increased** (15% import in 2021). Although the approved 2022 gas balance brings this back to 8%.

Significant difficulties exist in rational management of the gas flows and seasonal balancing of supply and demand. Gas consumption in Georgia is sharply seasonal: in winter the country consumes 2,5-3,5 times more natural gas per month than in summer. Significant deficit may arise, if special measures are not taken, during peak demand for gas in winter period. At present SOCAR is acting as a virtual storage for balancing Georgian market's supply/demand imbalances currently (Gotchitashvili, 2020).

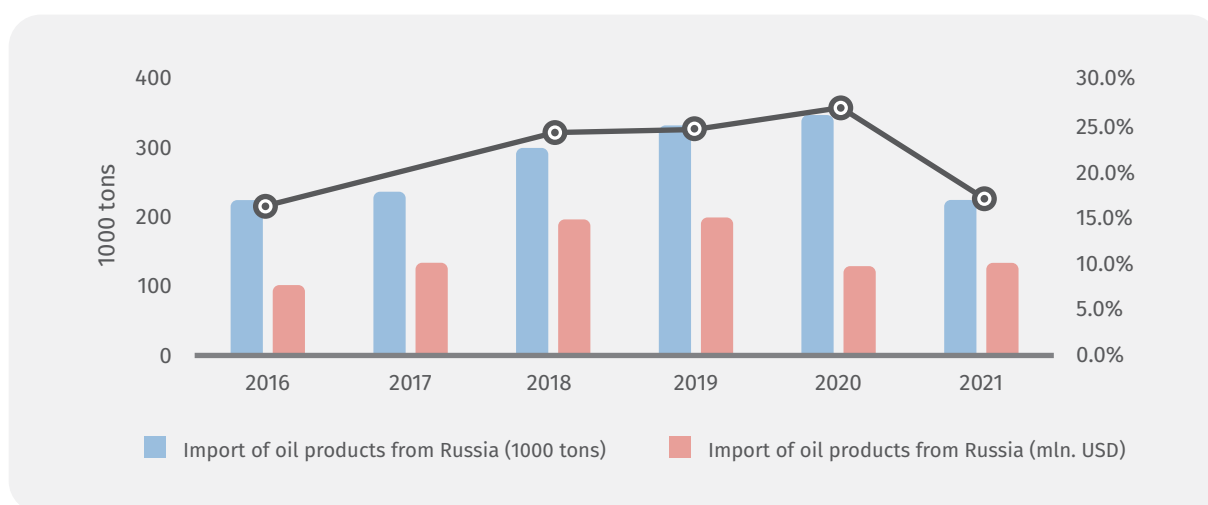
In addition, growth of electricity consumption causes increase of gas imports (due to thermal power plants). Import of gas from Russia therefore depends on several different factors and require complex approach.

Petroleum products

The market of petroleum products in Georgia is more diversified with import coming from several countries. In 2016-2020, average annual growth of import was 12% (see Graph 6).

Important portion of petroleum products (17% in 2021) is imported from Russia. If the imports get **restricted amid the ongoing war, deficit can be balanced by increasing imports from other countries.**

Notably, Georgia does not have any strategic reserves of petroleum products as required under the EU Directive 2009/119/EC.



GRAPH 6: IMPORT OF PETROLEUM PRODUCTS FROM RUSSIA

The above factors clearly indicate that energy import from Russia is a complex issue that requires a comprehensive analysis and monitoring. However, **in the short run, Russia does not acquire any major leverage against Georgia, both in terms of cutting off or threatening to cut off energy supply and using it for political blackmail.** Russia's leverage (not related to the ongoing war) may include encouraging corruption and creating non-transparent informal environment. This problem is not exclusive to the energy sector and its solution requires higher standards of transparency and accountability.

Openness of contractual terms and commitments with Russia is especially important. The recent developments once again call into question integrity of Russia as a contract party. The State should be interested in having open and transparent relations with Russia. In the long-term perspective, it is important that GNERC regulates gas transit fee. Transit terms should be open, transparent, and non-discriminatory.



Recommendations:

- The State should focus on the development of local power generation sources, to cover domestic demand and balance the import dependence, including imports from Russia;
- The State should facilitate the deployment of energy-efficient technologies in the entire chain of supply and consumption, where an important energy-saving potential exists;
- Georgia should reduce political and economic risks associated with reliance on energy imports. Supplies should be placed in a transparent and competitive environment and new supply alternatives should be developed;
- The State should prioritize the construction of a gas storage facility, as it will help the country create gas reserves, balance seasonal peaks in demand, and regulate imports;
- The country should build its oil refinery to supply the local market with petroleum products produced from local and imported crude oil. This will help diversify supply, reduce reliance on imports, stabilize prices and eventually, increase energy security; Georgia should strengthen the protection of critical energy infrastructure against kinetic and cyber threats as these risks are real amid the hybrid war with Russia
- Georgia should enhance the exploration of own hydrocarbon reserves and their optimal use to reduce the dependence on imports;
- Existing, outdated thermal power plants should be replaced by highly efficient combined-cycle power plants, to reduce gas consumption per unit of electricity generated.



ENGURI HPP AND ENERGY SUPPLY OF ABKHAZIA

The 1 300 MW Enguri HPP is probably the most critical energy asset for Georgia's energy system. It accounts for over 35% of the country's electricity supply. It provides an example **of cooperation between Georgians and Abkhazians as its high importance is well understood by both sides** (Enguri HPP, 2022).

Following the war in Abkhazia in 1993, Enguri HPP facilities ended up being on both sides of the dividing line: Powerhouse and substation of Enguri HPP and Vardnili 1 HPP are entirely left on the occupied territory of Abkhazia, while the dam, reservoir and part of the diversion tunnel remain on Georgian-controlled side. Following the war, an informal, verbal agreement was achieved about 40:60 division of the output of Enguri-Vardnili Cascade between the occupied Abkhazia and the rest of Georgia, which corresponded to the book value of assets on different sides of the administrative boundary. Since then, Electricity Consumption in Abkhazia region increases every year, and the Abkhazian side has been consuming electricity generated by Enguri cascade without limitation and without any financial reimbursement. In winter, Abkhazia's consumption exceeds Enguri/Vardnili output, so it needs to be supplied from the rest of Georgia or more recently also from Russia. **Electricity consumption by Abkhazia with a population of 250,000 (according to the latest estimates) is almost equal to that of Tbilisi with 1.5M residents** and per capita consumption exceeds more than twice the average of European Union (Margvelashvili, 2019).

The increased electricity consumption has several reasons. Abkhazia lacks adequate energy infrastructure, no proper metering and payment system; tariffs are low (about 2 Tetris for household consumers) but most people do not pay for electricity. Amid free consumption, mining of crypto currencies is on the rise. Natural gas is not available in Abkhazia, so electricity is the primary sources of energy including for heating.

Following the Russia's invasion of Ukraine, the challenges related to Russia's financial assistance and energy supply to Abkhazia Region become crucial. Local experts indicate that Abkhazia will receive some assistance from Russia, however it will not be sufficient to maintain the existing standard of living. They also estimate that given the sanctions, Abkhazia will see more tourists from Russia, and it will face an acute energy shortage. Electricity tariff increase is expected (Tania, 2022). According to new calculations, effective from July 1, households will pay 70 kopecks instead of 40 (approximately 0,8 cents), while for legal commercial entities the tariff will be increased from 80 kopecks to 1,4 rubles (approximately 1,7 cents). **The population is criticizing this decision. It is estimated that the collection rate (currently no more than 35%) will decrease even further** (Khashig, 2022).

Under these circumstances, electricity imports from Russia will likely be increased, and Abkhazia will try to take most of the power generated by Enguri HPP. Considering the importance of the Enguri HPP for the Georgian power system, it is crucial for the government, to analyze scenarios for enforcement of 40:60 split and work on emergency plans in case any risks arise to Georgia's management of Enguri HPP.

These circumstances however also create an opportunity to strengthen the cooperation with Abkhazians e.g., on upgrading the metering and payment system. This will be an important step forward in regulating energy consumption in Abkhazia and alleviating the pressure on Georgia's electric power system.



Recommendations:

- ⦿ It is important to strictly observe the 40:60 division of Enguri HPP output, strengthen discussions about potential shared benefits and try to find new, enforceable mutually beneficial agreements.
- ⦿ In the long-term perspective, the Government of Georgia should create a vision to address the problem of upgrading the metering and payment system in Abkhazia.



RUSSIAN CAPITAL IN GEORGIA'S ENERGY SECTOR AND THE CONSEQUENCES OF SANCTIONS

The overview of Russian presence in Georgia's energy sector has revealed the following (Dzvelishvili & Kupreishvili, 2015; Mtvlishvili, 2022): **Through intermediaries, Russian company Inter RAO owns 75% of Telasi, the electricity distribution company in Tbilisi; it also owns 75% of Telmico (Tbilisi electricity supply company) and hydropower plants Khrami I and Khrami II. Energy LLC, 70% of which belongs to a Russian citizen, owns Shilda HPP and Larsi HPP. Energy LLC also owns 44.27% of JSC Dariali Energy (Dariali HPP). Russia's Federal Grid Company - Unified Energy System (ПАО «ФСК ЕЭС») owns 50% of Sakrusenergo, a company owning the 500kV transmission grid and tie lines** connecting the power systems of Georgia with Russia, Azerbaijan, and Turkiye. To implement the relevant EU legislation, on January 4, 2021, an agreement was signed between JSC Sakrusenergo and JSC Georgian State Electrosystem (GSE), according to which JSC Sakrusenergo is required to lease to GSE electricity transmission lines for an indefinite period and ensure the maintenance and technical service for the transmission lines.

Analyzing the ownership structure in the energy sector, it is important to consider that as a field of state and public interest, it is subject to special regulations. Licensees are granted the power to carry out certain activities within the requirements of law. The Law of Georgia on Licenses and Permits specifies the activities that are subject to licensing. This includes the production transmission and distribution of electricity.²

The energy companies implementing these activities in Georgia are subject to licensing and must comply with license terms and requirements. **In case of violation of licensing conditions, the law provides safeguards, including the appointment of a special manager to companies by court.**³ There is a previous experience of such appointment to LTD Kastransgaz, where the special manager was appointed by the court in 2009 (GNERC, 2009). There is also a judicial precedent of appointment of a special manager to Georgian Manganese LTD.⁴

Therefore, **if any action or situation is perceived as a threat to national or public security, which may disrupt electricity or gas production/supply, the licensing authority (GNERC) may file an appeal in the court for the appointment of the special manager.**

Special manager is given the power to ensure compliance with the terms of license. Therefore, if, **e.g. electricity Distribution Company (Telasi) faces problems due to sanctions imposed on Russia, the State can protect the consumers from supply disruptions.**

At this stage, Georgia has joined financial sanctions, as confirmed by the National Bank. According to the Bank's guidelines (Feb. 26, 2022), financial sector companies licensed/registered in Georgia were required to consider and follow the terms of sanctions imposed on Russia by the United States, EU, and Great Britain. **In line with international sanctions, Georgian financial institutions are prohibited from providing services to physical and legal entities that are on the list of sanctioned entities.** Russian citizens that have been sanctioned do not have access to credit or guarantees provided by banks. **There is a possibility that denial of financial service from local financial institutions may lead to insolvency in a company and undermine its ability to meet its financial obligations. Such cases are addressed in the law, and the court can appoint a special manager in an event of violation of licensing terms because of insolvency.**

² Law of Georgia on Licenses and Permissions, paragraphs 15, 16 and 18 of article 6

³ Law of Georgia on Licenses and Permissions, paragraph 14 of article 22

⁴ Judgment of the Supreme Court of Georgia, chamber of administrative and other categories of cases, dated 13 Jul 2009, in the case no.BS-689-655 (k-ks-09).

Therefore, **ownership of assets in Georgia's energy sector by Russian citizens does not create additional major risks for functioning of the sector after the start of war.** However, the state should be closely monitoring and be prepared in case the problems arise. Although entities that carry out licensed activities are registered in Georgia, according to the Georgian law. However, the **government's position about ownership of assets by Russian citizens in any sector is a strategic decision that requires analysis** – whether the country is ready for deprivation or temporary restriction of property rights. Threats should be adequately assessed, and alternatives must be sought.

Although it is commercially insignificant for Russia but for political reasons it may demand from Georgia for natural gas transactions to be conducted in roubles. If such demand is made, which will certainly be politically charged, the government should have a position in agreement with its Western partners. Further, it needs to be determined how payments shall be made if sanctions are applied to all Russian financial organizations and formulate is Georgia's position on this issue.



Recommendations:

- It is important that competent authorities in the energy sector coordinate to systematically assess actual and probable risks and prepare respective action plans and scenarios.
- The Government should have a position about paying for energy transactions in Russian rubles and the position should be coordinated with Western partners.



EU'S ENERGY POLICY TOWARDS RUSSIA AND ITS CONSEQUENCES FOR GEORGIA'S ENERGY SUPPLY

In response to Russia's invasion of Ukraine, the United States, Great Britain, and the EU have imposed significant restrictions on the import of Russian gas, oil, and coal. The United States has fully banned Russian imports. Great Britain is planning to completely replace the import of Russian oil by the end of the year. The sixth package of sanctions adopted by the EU includes a complete import ban on Russian oil. Beginning in late 2022, EU member states will not be allowed to purchase oil from Russia (the rule will become operative for Slovakia and Hungary from late 2023) (Horton et al., 2022).

A complete ban on Russian gas imports is especially painful for the EU. 90% of natural gas consumed by the EU is imported while Russia's share in it is up to 40%. 27% of imported oil and 46% of imported coal are from Russia (European Commission, 2022).

In response to Russia's invasion of Ukraine, the EU decided to expedite its move to renewable energy sources, which according to the European Green Deal entailed a reduction of dependence on fossil fuels and turning the EU into the first climate-neutral continent by 2050. (European Commission, 2019). With the EU's new plan (REPower EU), which was initiated after the Russian invasion of Ukraine, the EU's critical dependence on Russian fuel will be phased out by 2027. Before that, **the EU is planning to reduce its dependence on Russian gas imports by two-thirds in 2022**. The European Commission also notes that „**for Ukraine, Moldova, and Georgia, the EU stands ready to provide support to ensure reliable and sustainable energy**“ (European Commission, 2022).

According to the EU External Energy Strategy, **Azerbaijan also plays a role in substituting Russian gas imports in the EU**. According to Azerbaijan's state oil company – SOCAR, in 2022, Azerbaijan will increase by 30% the volume of natural gas supplied to Europe (Business Standard, 2022). **Azerbaijan's Minister of Energy has said that (Turan, 2022) Azerbaijan „has 2.6 trillion cubic meters of natural gas reserves, which is enough for its neighbors and European countries.“**

Azerbaijan supplies gas to Europe through the Southern Gas Corridor. The corridor entails South Caucasus Pipeline (SCP), Trans-Anatolian Gas Pipeline (TANAP), and Trans-Adriatic Pipeline (TAP). SCP route goes through Georgia. Interestingly, the route was initiated by the EU, after Russia unexpectedly cut off the gas supply to Ukraine and through Ukraine to Europe in the winter of 2009 (GOGC, 2019).

According to Azerbaijan, it can increase TANAP volumes from 13 billion m³ to 31 billion m³, and double TAP volumes up to 10 billion m³ (Turan, 2022). This means that the volume of gas available to Georgia at a preferential price (5% of throughput) will also be increased (as noted earlier, “social” gas is supplied to household sector and thermal power stations in Georgia at a preferential price (GOGC, 2022).

It should however also be noted that an **increase of Azerbaijani gas imports to EU may affect the prices of commercial gas supplied to Georgia**. According to the agreement between Georgia and Azerbaijan's state oil company SOCAR, the latter provides to Georgia additional volumes of natural gas, in the form of the so-called commercial gas. The agreement is valid until 2030. Its details are not publicly disclosed (WEG, 2017). It is likely that the agreement balances the difference between the transmitted volumes and the actual consumption by so-called social sector. SOCAR supposedly also undertakes to ensure continuous supply, irrespective of changes in seasonal consumption.

Tariffs for the supply of natural gas to non-household consumers is deregulated under the Ministerial Order N69 of 2007. Thus, unlike households, the commercial gas price is not regulated by GNERC, and

non-household customers are left vis-à-vis monopolistic supplier without any legal restrictions on price. Commercial tariffs that are determined based on unclear principles are higher than household tariffs and vary according to types of organizations and subsectors (e.g., bread factories, public organizations, the religious organizations etc. pay less than other legal entities).

Following the increase of prices and demand, SOCAR may be motivated to supply more gas to the EU, which may subsequently affect availability or price of commercial gas in Georgia. The agreement with SOCAR should be made public, for people to know how the ongoing developments may affect gas prices in Georgia and if the existing agreement takes into account such a possibility.

Openness and transparency are principles of European legislation that reduce corrupt and illegal deals to a minimum. Classified contracts create suspicions about possibility of corrupt deals and form a solid ground for spreading disinformation. When it is impossible to verify information and in absence of citizen oversight, suspicions and myths appear as a simple way for manipulation, for misleading people and disseminating fake information.

In circumstances of excess of gas in Russia and increased demand for Azeri gas in the EU. **Russia may attempt to flood Georgia's small (2.5bcm) market with own gas at dumping prices in an attempt to take over the control of the market.** Georgian government needs to prepare the position and be prepared on how to avoid the Russian gas domination in future.



Recommendations:

- ⦿ Amid the increased demand, the mechanism for gas price subsidization for households should be reviewed. The targeted assistance programs including energy efficiency measures should be improved and directed only for vulnerable consumers.
- ⦿ It is expedient to take measures for transparency and non-discrimination in gas pricing for non-household gas customers. Existing agreements and principles for price regulation should be made public. Pricing should be established based on transparent regulation.
- ⦿ The government should consider the mechanisms for protection of Georgian gas market from Russian influence. Establishing a single-buyer mechanism seems to be most practicable in this sense.

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