

Security of Supply - Oil Sector

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1.1. Key players

The main policymaker in the field of oil operations is the Ministry of Economy and Sustainable Development of Georgia (Ministry). The Ministry sets the policy and strategy as well as approves long term plans for the sector.

The State Agency of Oil and Gas (SAOG) – the Legal Entity under Public Law within the Ministry, is responsible for oil and gas operations. SAOG is responsible for creating appropriate environment for oil and gas operations on a non-discriminatory basis, organizing tenders and auctions, issuing licenses on behalf of the state, signing contracts with investors, monitoring the implementation of licenses and contractual obligations.

The JSC Georgian Oil and Gas Corporation (GOGC) – carries out operational and commercial rights and duties delegated by SAOG in accordance with the Georgian legislation. GOGC collaborates with investors to plan and fulfill operations; contributes to unimpeded operation of transboundary oil transportation systems on the territory of Georgia; supports development of new transit routes for energy potential of the Caspian and Black Sea basins; is actively involved in international projects and business relations partnering with: SOCAR, Shah-Deniz Consortium, BP, BOTAS, etc. Securities (bonds) of GOGC are placed and successfully traded at London Stock Exchange.

Four big oil terminals operate on the territory of Georgia: Batumi Oil Terminal, Poti oil terminal, Kulevi oil terminal and Supsa. All they are located on the Black Sea shore and serve export or transit purposes. Besides there are some smaller ones on different parts of the country.

1.2. Legal and Regulatory Frameworks

The core legal act is the Main Directions of the State Policy in the Energy Sector of Georgia (approved by the Parliament of Georgia on June 24, 2015). The legislative frameworks include The Law of Georgia on Oil and Gas, Order N2 on Approval of the National Regulations for of Oil and Gas Operations, as well as the law of Georgia on Licenses and Permits. According to the latter licenses are required for:

- Oil and/or gas processing
- Oil and/or gas transportation
- Exploration of oil and gas
- Production of oil and gas

The Government supervises only two directions of the oil market: market competition and quality control. To ensure the fair competition, market monitoring is provided by the Competition Agency under the Law of Georgia on Free Trade and Competition. The quality standards are determined by two Resolutions of the Government of Georgia: N124 of 31 December 2004 on the Quality Norms of Petrol and N238 of 28 December 2005 on the Norms of Composition of Diesel Fuel, Methods of Analysis and Implementation Measures.

The State quality control mechanism for fuels in Georgia is divided in to three directions:

- 1 SAOG is responsible for monitoring quality of oil products which are produced by its Business License holders;
2. The Revenue Service (the Legal Entity under Public Law within the Ministry of Finance of Georgia) is responsible for monitoring quality of oil products imported to Georgia;
3. The State Sub-Agency Department of Environmental Supervision (within the Ministry of Environmental Protection and Agriculture of Georgia) is responsible for monitoring quality of oil products in Georgian retail networks.

The import of transport fuel into Georgia is not subject of licensing. Therefore, there are no significant legislative restrictions on the entry into the fuel market. Under the Tax Code of Georgia, oil products are in the excise goods category.

1.3. Domestic production

Crude oil produced in Georgia accounts for only 2% of the domestic supply of oil products. At present, 16 deposits are being processed in Georgia, including 15 oil and 1 gas. According to the estimations for 2020 the proven 1P category oil reserves within the fields discovered in Georgia are 3.2 million tons; 2P category reserves - 7.8 million tons; Conditional, available resources in the 3P category - 41.51million tons. The total volume of prospective oil resources estimated on the promising onshore and Black Sea offshore exploration areas are about 909.2 million tons (best estimate).

On most of the country's oil and gas prospective onshore areas, production sharing agreements have been signed with the relevant licenses. Oil and gas operations in Georgia are carried out by several international and domestic companies: MND Group/ Blake Oil and Gas Limited (license blocks: XIC, XID, XIE,); Frontera Eastern Georgia (License Block XII); WGPEC (License Block V); GCE Ltd (license blocks VIA, VIB); Georgian Oil and Gas (License Blocks VIII, XIG, XIM, XIN, XIC Martkopi, XIC North Horseback Riding, IXA, XIK, XIL, XIV); Nautic AWT Energy PTE LTD (License Block VIIB); Georgian Oil and Gas Corporation (License Block XIB SSD); Block Energy (license block IX, XIB, XIF, XIC Norio-Satskhenisi, XIC Satskhenisi).

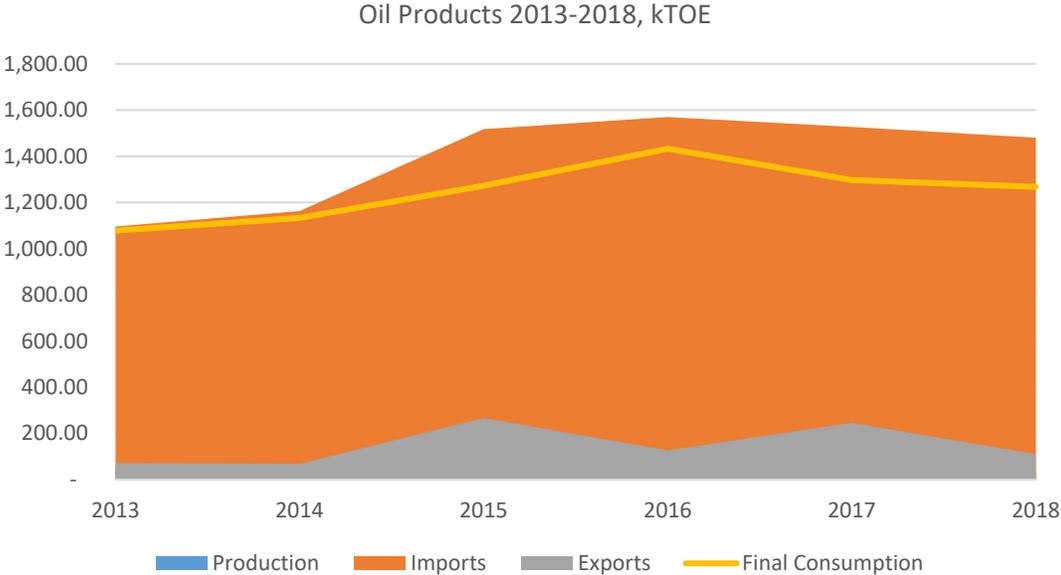
GOGC with the status of a National Oil Company, supervises the state share of extracted oil and gas at the planning, implementation and licensing stages.

Part of the oil extracted in Georgia is exported through Batumi and Poti terminals, while a significant part is processed in local small-capacity oil refineries. According to SAOG currently two licensed oil refineries operate in the country: Veli Ltd. and Zd Oil Company Ltd, with the capacity of 80,000 tons and 130,000 tons of crude oil per year, respectively.

1.4. Import and Export

According to the National Statistics Office of Georgia (GEOSTAT), the final energy consumption of Georgia for 2018 was approximately 4390.1 kTOE. The share of the oil products reaches up to 29% (1267.4 kTOE).

Almost all oil products are imported. Because of the minor extraction of crude oil (30.7 kTOE for 2018) there is practically no production.

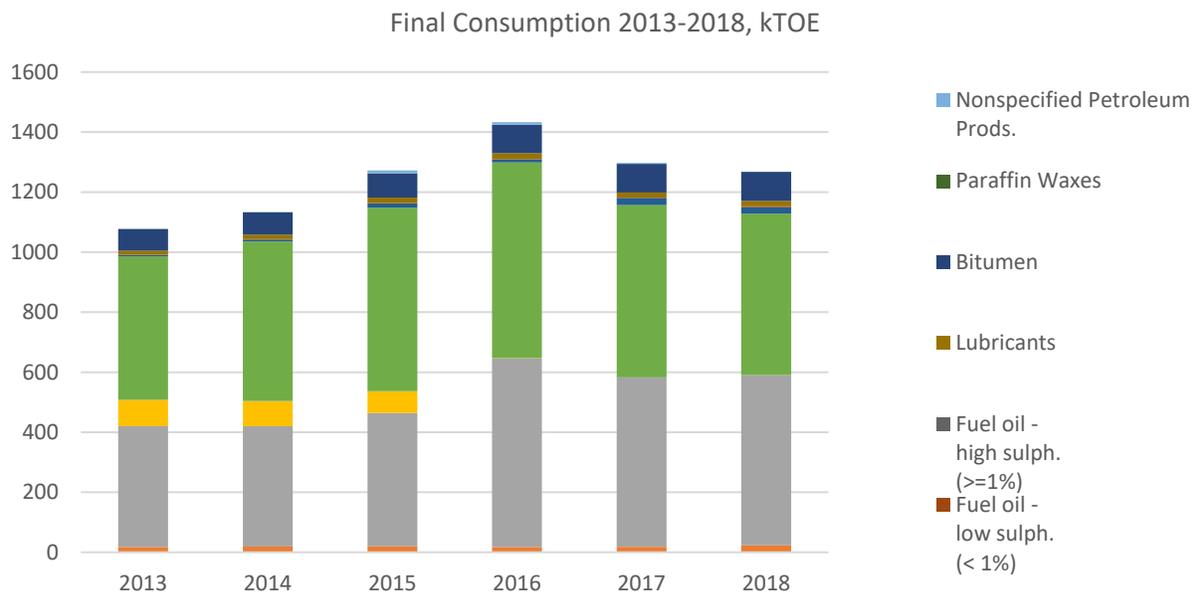


Five major companies (JSC Wissol Petroleum Georgia, Ltd San Petroleum Georgia, Ltd Rompetrol Georgia, SOCAR Georgia Petroleum, Ltd Lukoil Georgia) are operating on petroleum products'

wholesale and retail market. Their share is about 70-75% of the business total turnover and they possess petrol stations on the entire territory controlled by the Government of Georgia.

Majority of oil products are supplied from Azerbaijan and Russia, as well as from Bulgaria, Romania, Greece, Italy, Turkmenistan and other countries. Recently, about 1-1.1 million tons of gasoline and diesel fuel have been imported to Georgia every year.

The most consumed petroleum products are Road Diesel and Motor Gasoline. Almost 88% of the oil products is used in the transport sector. Beside local transport the Georgian petroleum market serves transit vehicles in the country's airspace, as well as airports and seaports.



The market of crude oil and oil products in Georgia is completely liberalized and the prices more or less reflect the trends of the international market.

1.5. Transit

Georgia is an oil transit country. Two pipelines - the Western Route Export Pipeline (WREP) and the Baku-Tbilisi-Ceyhan (BTC) transport oil through the territory of Georgia.

The 830km WREP transports oil from the Chirag field in the Caspian Sea via the Sangachal terminal in Azerbaijan to the Supsa terminal in western Georgia. It is capable of transporting up to 7 mln.tons/year and Supsa terminal capacity is 160 thousand tons.

The Baku-Tbilisi-Ceyhan (BTC) pipeline is a 1,768-kilometer long crude oil pipeline from the Azeri-Chirag-Guneshli oil field in the Caspian Sea to the Mediterranean Sea. It connects Baku and Ceyhan, a port on the southeastern Mediterranean coast of Turkey, via Tbilisi. Its capacity is 60 mln.tons/year. The maximum annual load of the pipeline was 38 mln.tones.

The majority of oil passed through the pipelines is produced in Azerbaijan. Relatively small amount comes from Kazakhstan and Turkmenistan.

In addition, railroad and seaports (using Batumi, Poti and Kulevi oil terminals) carry out the transit of crude oil and petroleum products from Azerbaijan, Kazakhstan and Turkmenistan.

1.6. Development of the Sector to Improve SoS

The share of imported oil products in the structure of total primary energy consumption of Georgia is about 26%. That leads country to the critical dependence on expensive, imported hydrocarbons and is one of the main challenges to the security of supply.

At the same time, the efficient development of the country's own hydrocarbon resources could make a significant contribution to the growth of the country's energy security and economy in general.

In addition to the fundamental problem associated with the import of critical volumes of basic fuel resources there are different direction that need the special effort:

Widening of the exploration works of new deposits

Efficient use of the existing resources and the discovery of new deposits are of great importance for increasing the share of local resources in the country's energy balance and thus ensuring security of supply. Therefore, extensive use of modern methods and technologies of production on existing fields and to discover new ones through exploration and deep well drilling, expansion and qualified production is of special importance for Georgia. Even with only 5% of the proven reserves at existing fields, oil extraction could increase 2.5-3 times compared to the figures of 2018.

The results of exploration work carried out in different regions of the country in recent years (2D and 3D dimensional seismic exploration, unit search wells) convincingly indicate the rather high probability of opening of new commercially feasible hydrocarbon deposits.

The Black Sea offshore of Georgia is considered as an especially promising. In the northern part of Georgia offshore, several large structures (Gudauta, Ochamchire, Kulevi) were delineated during the Soviet period by seismic surveys. The southern part of offshore was studied by US company Anadarko in the first decade of 2000s, however, no exploration drilling has been carried out on to date. Intensive and costly works are needed to increase local oil and gas production, including:

- It is planned to introduce modern oil and gas exploration (3D seismic exploration and data interpretation, hydrodynamic modeling of reservoirs) and extraction (horizontal drilling, deep multistage hydraulic fracturing) technologies, both within the prospective and newly discovered, as well as within the already advanced producing stage.
- Large-scale seismic exploration and assessment drilling will be planned and carried out to assess commercial significance in prospective areas, including deep-seated prospective layers.
- Contractor companies with an appropriate qualifications and reputation will be licensed for exploration blocks located on the Black Sea offshore of Georgia to start drilling works in promising offshore structures.

Enhancement of the professional knowledge and experience

For further improvement of local intellectual resources and experience, the government facilitates the proper involvement and participation of local professional resources in solving key issues of the sector, which in turn will create a significant number of new jobs and take the vital interests of the country into account.

The government is keen to facilitate the training of students and other local specialists by organizing and promoting internships in fields, exchange best practices with leading countries and companies.

The government will strengthen the role of the Georgian side in the scientific-analytical support of the works performed by the contractors.

One of the main task is creation of the unified national database of geological structure and oil deposits. The database will combine all the primary data stored in SAOG, GOGC and the country in general. At the same time procedures will be developed to facilitate contractors' access to the key components of the database, and, if necessary, to provide scientific-analytical research on exploration, extraction and other topical issues of the field.

Improvement of the corresponding legislation

In order to ensure the proper influence of the state the existing complex and unbalanced procedures have to be revised. As a result, the state (SAOG) will have the opportunity to be actively engaged and, if necessary, block the practical implementation of some of the contractor's decisions for which there is no proper justification. For this purpose:

- Appropriate amendments will be made to the national rules specifying requirements for the field development plans and their practical implementation.
- All contractors will be required to comply with the requirements relating to the annual accounting and reporting of oil and gas resources and supplies. The issue of accounting and permanent updating of the assessed resources and supplies on the state balance will be regulated.
- Changes will be made in the procedures defined by the legal norms for conducting license tenders, which will ensure proper consideration of the experience and competence of winning company.

Development of new oil refining capacities

In order to determine the feasibility of the new oil refinery facilities, for at least partial meeting of needs of the country and the possibility of exporting high quality and ecologically safe fuels in demand in the regional market, the policy of promoting the attraction of potential investors will be continued.

The favorable geographical location of the country, the existing infrastructure (oil and gas pipelines, railways and seaports) and the prospects for local extraction, according to a preliminary assessment, form good preconditions for the construction and operation of a regional oil refinery in Georgia.

Enhancement of the transit potential of Georgia

More than 40% of the existing transit potential of Georgia is still not used. Thus, current and future transit flows through Georgia will be related to the oil produced and processed in Azerbaijan, Kazakhstan, and, to a lesser extent, Turkmenistan.

Presidents of countries participants of the Eurasian Oil Corridor Project (EAOTC) project (Azerbaijan, Georgia, Lithuania, Poland and Ukraine) signed a communiqué supporting the transit of Caspian oil via the Odessa-Brody pipeline, as well as its extension to Plock, from where the oil will to reach Gdansk via the existing pipeline.

On the basis of the above mentioned the international pipeline company Sarmatia Ltd. was established. The shareholders of the company are SOCAR (Azerbaijan), AB Klaipėdos Nafta (Lithuania), PERN Przyjaźń S.A. (Poland), Ukrtransnafta (Ukraine) and JSC Georgian Oil and Gas Corporation (Georgia). The share of GOGC in Sarmatia Ltd at this stage is 16.9%.

The main goal of Sarmatia Ltd. is the implementation of the Eurasian Oil Corridor Project (EAOTC).

Compulsory Stocks

As an Energy Community member state Georgia has to fulfill the requirements of the Acquis on oil – Directive 2009/119/EC imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products. Implementation Deadline is 1th of January 2023.

Compulsory emergency stocks have to be created and stored to ensure uninterrupted supply of market with petroleum products. Compulsory emergency stocks are energy products at the disposal or under the control of the government and are constituted, in order to ensure a high level of security of supply in Georgia, to maintain national security, to perform the obligations assumed under international agreements and to guarantee subsistence to the population

The compulsory stocks are to be constituted of:

- Motor gasoline
- Jet fuel
- Kerosene
- Diesel fuel,
- light fuel oil and
- Heavy fuel oil

In case of Georgia, where almost all oil products covered by the energy balance of the country are imported, the obligation is to maintain stocks of oil and/or petroleum products responding to 90-day net import volume.

SAOG is stipulated as the Central Stockholding Entity (CSE). The emergency stockholding obligation will apply to any economic operator, which imports crude oil or products produced from oil and bituminous minerals on a commercial basis or manufactures it in Georgia.

Thus, from January 1, 2023, when the legislation is in force, every compulsory stockholder will be required to hold emergency stocks equal to 25% of their imports of crude oil or petroleum products during the reference year.