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**PRIVATIZATION PLAN FOR THE GEORGIAN OIL
AND GAS SECTOR**

**Georgia Oil and Gas Sector Reform
Contract No. LAG-I-00-98-00005-00
Task Order No. 5**

Final Report

Prepared for:

U.S Agency for International Development
Bureau for Europe and the NIS
Office of Environment, Energy and Urban Development
Energy and Infrastructure Division

Prepared by:

Hagler Bailly
1530 Wilson Boulevard
Suite 400
Arlington, VA 22209-2406
(703) 351-0300

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1

PRIVATIZATION PLAN FOR THE GEORGIA OIL AND GAS SECTOR

This is the Privatization Plan called for by Subtask D of Contract No. LAG-I-00-98-00005-00, Task Order No. 5, that Hagler Bailly develop an updated plan "for increasing private sector participation and private investment" in the Georgia oil and gas sector. The plan draws upon the following:

- ▶ The revised work plan for Subtask D of Task Order 5, submitted to USAID for review and comment in draft form on March 22, 1999;
- ▶ Hagler Bailly's work and experience under Task Order 5, which began in September 1998 and has continued to date.

Of necessity, Hagler Bailly's work under this Subtask relates to and must be integrated with our work under each of the other Task Order 5 Subtasks, particularly Subtasks A (Restructuring), B (Legal and Regulatory Reform), and C (Commercialization). Privatization Plan therefore refers to activities under the other Subtasks, as appropriate.

This Plan identifies and discusses the major items of work that Hagler Bailly has been implementing and/or will implement under Subtask B for the duration of Task Order 5. In general, the plan lists the items of work in order of importance to the legal and regulatory reform effort.

Background

Virtually all petroleum products, including gasoline and propane, delivered to the consumer in Georgia are sold by private-sector entities. The prices for such products are, by and large, determined by the market. In major respects, therefore, the Georgian oil and gas sector has already been privatized. Remnants of the old, Soviet State-owned oil and gas enterprises remain, but because they do not directly control either petroleum commodities or the prices for petroleum products, their continued presence is less intrusive than in other sectors.

In the area of oil and gas exploration and development, the single biggest obstacle to promoting private investment has been the absence of a single, regularized system of contracting and permitting. Instead, prospective investors have been left to negotiate agreements with different agencies or other representatives of the Government of Georgia (GoG), each making different and, often, conflicting demands. To remedy this situation, and to promote private investment, USAID has sponsored, and Hagler Bailly has implemented, the development of an oil and gas law to address these problems.

All natural gas is currently supplied from beyond Georgia's borders, so there is little to be privatized by way of supply. GoG has designated the principal natural gas pipeline from Russia a strategic assets, not to be sold. That leaves the natural gas distribution companies, the largest of which GoG privatized, with the exception of Tbilgazi, the distribution enterprise for the City of Tbilisi. It is to the privatization of Tbilgazi that Hagler Bailly has turned under this Subtask, along with promulgation of legislation to regulate the natural gas industry.

1. Oil and Gas Law

From the earliest days of the energy sector reform program, USAID identified the enactment of a law to govern the exploration and development of Georgia's oil and gas resources as a legal reform priority to promote private investment in the sector. Under existing Georgia law, Saknavtobi, the state-owned petroleum enterprise, handles all contractual relationships governing the exploration, development, and refining of crude oil and natural gas produced in Georgia. Saknavtobi lacks, however, legal standards for the contents of such contracts, and as a result, existing production sharing and related contracts with foreign investors include various, often inconsistent or conflicting, privileges and responsibilities. Moreover, in Saknavtobi, the government's sovereign, regulatory, and commercial interests are inappropriately intertwined. It is essential that an Oil and Gas Law, setting forth appropriate standards and delegating government interests to different agencies, address and correct these deficiencies. As stated in Task Order 5 and in the Subtask B work plan, the Oil and Gas Law should address, at a minimum, licensing requirements for exploration and development (including the identification of the appropriate agency to issue licenses and to regulate conduct under them), the elements of contracts for upstream production, regulatory standards, and production sharing. The Law should confirm the validity of existing oil and gas contracts, and separate the Government's regulatory authority from its commercial interests, and delegate these items to two different agencies. The statute should also rationalize tax treatment for oil and gas investments, contracts and production, and provide for international arbitration of disputes. If successful, an oil and gas law with these characteristics would promote private investment in exploration and development.

Timing: Hagler Bailly has been working on the many different drafts of an Oil and Gas Law (and drafted one of the earliest versions) since mid-1997. Drafting and re-drafting the Oil and Gas Law, and consulting with counterparts regarding international standards, served as a major activity under Delivery Order 16, which expired at the end of September, 1998. Hagler Bailly has continued its work on the Oil and Gas Law unabated during the term of Task Order 5.

The Georgia Parliament conducted its third and final reading of the Law on Oil and Gas on 16 April 1999. President Shevardnadze signed the law on 3 May 1999.¹

2. Amendments to the Electricity Law to create a program of regulation of natural gas supply, transportation, and distribution

Although there are Georgian laws on the books permitting municipalities, with the approval of the Ministry of Economy, to regulate retail rates for natural gas, the authority is sporadically and ineffectually utilized, and the industry (to the extent that there is one) is essentially unregulated. The absence of regulation became a concern in the context of the reform effort in early 1998, when affiliates of Gazprom purchased six large distribution companies (including Tbligas, the distribution enterprise for Tbilisi) and Rustavi Cement, the largest industrial consumer of natural gas in Georgia. At about the same time, another Gazprom affiliate executed an agreement with Saktransgasmretsvi, the Georgian natural gas pipeline enterprise, under which it would operate and manage the pipeline for the Georgians. Although the specter of Russian-controlled gas hegemony in Georgia has abated somewhat,² the possibility of an unregulated monopoly in natural gas prompted an examination of the question by USAID and World Bank. Eventually, World Bank included a requirement for natural gas regulation in its ESAC conditionalities in December, 1998, a possibility that USAID had already anticipated in Task Order 5.

Hagler Bailly prepared amendments to the Electricity Law of 1997 (to be renamed to reflect its post-amendment identity as an energy law) to give the Georgian National Electricity Regulatory Commission (also to be renamed) the authority to regulate the supply, transportation, and distribution of natural gas through a system of licenses and tariffs. These amendments, when enacted, will promote privatization by assuring certainty of price and other aspects of natural gas service.

Timing: Hagler Bailly prepared a first draft of the natural gas amendments during the Fall of 1998, and circulated the draft for review and comment to USAID and World Bank prior to having the draft translated and presented to counterparts in November. In December, 1998, Hagler Bailly joined the working group formed by GoG for the purpose of finalizing the natural

¹ A description and copy of the law appear in Hagler Bailly, "Report on the Georgian Law on Oil and Gas," May 20, 1999.

² For one thing, the Ministry of State Property Management declared, during the first quarter of 1999, that the Gazprom affiliate had breached its agreement to purchase Tbilgas by failing to agree to assume an appropriate share of the distribution enterprise's debt, and declared the purchase agreement void. For another, Saktransgasmretsvi repudiated the management agreement, claiming that the Russians had failed to abide by their obligations.

gas amendments to the Electricity Law, and worked with the group on the amendments during the last half of December and the first half of January. When in late February the Chancellery presented the Parliament with a package of amendments that differed from that on which the working group had earlier agreed, Hagler Bailly worked with the staff of Chairman Tskitishvili's Committee on Reform of the Economic Sector to prepare appropriate revisions.

Parliament approved the amendments on their third reading on 30 April 1999, and President Shevardnadze signed the legislation two weeks later.³

Privatization of Tbilgazi

In January 1998, GoG offered six of the largest natural gas distribution enterprises in Georgia for sale, resulting in the sale of controlling interests in the municipal distribution companies Kutaisgazi, Bolnigazi, Rustavgazi, Marneulgazi, Kaspigazi, and Gorigazi. During the second half of the year, the Government conducted a commercial tender for 76% of the shares of Tbilgazi, the distribution system for Tbilisi. The tender announcement stated a selling price of US\$6 million and required the purchaser to invest not less than US\$30 million within two years for rehabilitation and development of the gas distribution system. In August 1998, the Ministry of State Property Management (MoSPM) approved Intergaz (later renamed Sakgaz) as winner of the commercial tender. Subsequent discussions between MoSPM and Sakgaz related to the level of debt to be assumed by Sakgaz led to non-payment of the purchase price and, in February 1999, cancellation by MoSPM of the tender award.

MoSPM approached Hagler Bailly in April 1999 to request technical assistance in offering Tbilgazi for privatization. With USAID's consent, Hagler Bailly commenced offering its assistance in April, which has continued throughout the term of Task Order 5. That technical assistance has consisted of two principal items: the preparation of a draft Information Memorandum to be circulated to potential investors, and subsequent revised drafts (the document is currently in its third major revision); and the preparation of tender documents.

Timing: Hagler Bailly completed the first draft of the Information Memorandum in June 1999. The current working draft is the third (Attachment A).⁴ We expect formally to begin circulating the Information Memorandum by the end of July 1999. Hagler Bailly has also completed, and revised based on comments, a Request for Proposals for Tbilgazi (current draft, Attachment B). We also expect MoSPM formally to issue the Request for Proposals by the end of July 1999.

³ See Hagler Bailly, "Report on Legislation to Regulate the Supply, Transportation, and Distribution of Natural Gas," June 14, 1999.

⁴ Attachment A does not include the numerous exhibits and tables that will be included in the bound copies of the Information Memorandum distributed to potential investors. As reflected by the Memorandum's Table of Contents, those addenda are numerous.

Conclusion

As of the closing date for Task Order 5, Georgia had achieved two milestones relevant to privatization and private participation in the oil and gas sector: passage of the Law on Oil and Gas, which provides the framework for new investment in exploration and development in hydrocarbons; and enactment of the amendments to the Electricity Law that confer authority on GNERC to regulate natural gas supply, transportation, and distribution, which should promote interest in privatization of Georgia's remaining State-owned natural gas assets. As to one of those assets, Tbilgazi, Hagler Bailly has made substantial progress toward assisting GoG to prepare the asset for privatization.

Attachment A: Draft Tbilgazi Information Memorandum

Attachment B: Draft Tbilgazi Request for Proposals

ATTACHMENT A
DRAFT TBILGAZI INFORMATION MEMORANDUM

**Tbilgazi Gas Distribution Company
Tbilisi, Georgia**

Information Memorandum

Prepared for:
Ministry of State Property Management
64 Chavchavadze Avenue
Tbilisi, Georgia

And

JSC Tbilgazi
18 Mitskevichi
Tbilisi, Georgia

Prepared by:
Hagler Bailly Services, Inc.
25 Luxembourg Street
Tbilisi, Georgia

July 1999

TBILGAZI

INFORMATION MEMORANDUM

This Information Memorandum (“Memorandum”) is based on information provided by the Georgian Ministry of State Property Management (“MSPM”) and Tbilgazi (“Tbilgazi” or the “Company”), a Joint Stock Company (“JSC”) engaged in the distribution of natural gas in Tbilisi, Georgia. It is being delivered on behalf of the Company by the MSPM to a limited number of parties who may be interested in the potential acquisition of seventy-five (75) percent of the shares of Tbilgazi. The sole purpose of this Memorandum is to assist the recipient in deciding whether to proceed with a further investigation of the Company. This Memorandum is not, and does not purport to be, all-inclusive or to necessarily contain all the information that a prospective purchaser may desire in investigating the Company.

This Memorandum has been prepared for informational purposes only, and is being delivered upon the express understanding that it will be used for only the purposes set forth above. The Memorandum contains unaudited financial statements and other statements related to the assets, liabilities and operating data of the Company that have not been independently verified. The Memorandum also may include certain statements, estimates and projections related to the anticipated or potential future performance of the Company. Such statements, estimates and projections reflect various assumptions made by the Company, which may or may not prove to be correct. It is expected that any person or entity who wishes to purchase the Company will be a sophisticated and knowledgeable investor familiar with the natural gas sector and the privatization of State-owned assets in developing countries. Each such investor should conduct its own independent investigation and analysis of the Company. Accordingly, neither the Company, MSPM nor the Government of Georgia makes any express or implied representation or warranty as to the accuracy or completeness of the information contained herein or made available in connection with any further investigation of the Company. The Company, MSPM and the Government each expressly disclaim any and all liability that may be based on such information, errors therein or omissions therefrom. The recipient shall be entitled to rely solely on the representations and warranties, if any, made to it by the Company or the Government in any final purchase agreement.

In furnishing this Memorandum, neither the Company, MSPM nor the Government undertakes any obligation to provide the recipient with access to any additional information. This memorandum shall not be deemed an indication of the state of affairs of the Company nor shall it constitute an indication that there has been no change in the business or affairs of the Company since the date hereof.

All communications, inquiries and requests for information relating to these materials should be addressed to representatives of the MSPM listed below. Under **NO** circumstances should the management of the company be contacted directly.

Ministry of State Property Management

David Gelashvili
Deputy Minister
Ministry of State Property Management
64 Chavchavadze Avenue
380062 Tbilisi, Georgia
Telephone: (995 32) 29 27 02, 29 30 72
Facsimile: (995 32) 29 30 65

George Machaidze
Director, Department of Restructuring and Privatization
Ministry of State Property Management
64 Chavchavadze Avenue
380062 Tbilisi, Georgia
Telephone: (995 32) 29 35 94
Facsimile: (995 32) 29 00 04

July 1999

Copy Number _____

TBILGAZI

Information Memorandum

Table of Contents

1. EXECUTIVE SUMMARY	Page
1.1. Background to the Transaction	1
1.2. Tender Process	1
1.3. Business Overview	2
1.4. Georgia - Facts and Investment Climate	2
1.4.1. Geography, History and Demographics	2
1.4.2. Post Soviet Political History	3
1.4.3. Government Structure	4
1.4.4. Investment Climate	4
2. KEY INVESTMENT CONSIDERATIONS	
2.1. The Georgian Natural Gas Sector	5
2.2. Industry Regulation	6
2.2.1. Regulatory Authority	6
2.2.2. 1999 Amendments to the Electricity Law	6
2.2.3. Licensing Regime	6
2.3. Natural Gas Pipeline Network	7
2.4. Gas Supply	8
2.5. Competition	8
3. TBILGAZI - ASSET AND CUSTOMER INFORMATION	
3.1. Distribution System	8
3.2. Current Tariffs and Customer Information	9
3.3. Potential for New Customer Service	10
3.4. Potential for Improvements - Distribution System and Collections	11
3.5. Metering, Billing and Collections	11
3.6. Distribution License and Tariffs	12
4. ORGANIZATION AND MANAGEMENT	
4.1. Organizational Structure	12
4.2. Senior Management and Staff	13
4.3. Security Ownership	14

5. FINANCIAL PERFORMANCE

5.1. Summary	14
5.2. 1998 Financial Data	14

6. LEGAL, SAFETY AND ENVIRONMENTAL

6.1. Legal	15
6.2. Safety and Environmental	15

Exhibits

1. Map of the Gas Distribution System
2. Unaudited Financial Statements
 - Unaudited Balance Sheet
 - Unaudited Income Statement
3. Certain Georgian Laws Affecting Privatization and the Investment
 - Law on Privatization of State Property
 - 1999 Law on Electricity and Natural Gas
 - Law on Entrepreneurs
 - Law on Promotion of and Guarantees of Investment Activity

Tables

- Table 1. Characteristics of the Georgian Gas Pipeline Network
- Table 2. 1998 Tbilgazi Monthly Volumes
- Table 3. Tbilgazi System – Size and Pressure Specifications
- Table 4. 1998 Monthly Gas Service by Customer
- Table 5. 1989 Tbilgazi Customers
- Table 6. Apartments Connected to the Distribution System – May 1999
- Table 7. Tbilgazi Senior Management
- Table 8. Tbilgazi Employees
- Table 9. 1998 Collections and Payment Data

1. EXECUTIVE SUMMARY

1.1. Background to the Transaction

The Government of Georgia acting through the Ministry of State Property Management is privatizing certain State-owned enterprises in the natural gas and electricity sector. As part of this continuing program, the Government will offer Tbilgazi, a Georgian JSC engaged in the distribution of natural gas in Tbilisi, Georgia, for privatization via a competitive tender process.

The Government intends to sell a controlling interest (75%) in Tbilgazi to a strategic private investor ("Investor"). As required by current Georgian legislation, up to ten (10%) percent of the Company's shares will be offered to employees of the Company and ultimately, the remaining State shares may be offered at auction to the public.

The privatization of Tbilgazi offers a strategic investor a unique opportunity to participate in and benefit from the rehabilitation and development of the natural gas sector in Georgia. The Georgian natural gas sector and, in particular, the local gas distribution system within the capital city of Tbilisi has significant growth potential.

In January 1998, the Government began the process of privatizing several of the larger municipal gas distribution companies in Georgia. This effort resulted in the sale of a controlling interest in the municipal distribution companies Kutaisgazi, Bolnissgazi, Rustavgazi, Marneulgazi, Kaspigazi and Gorigazi.

During the second half of 1998, the Government conducted a commercial tender for 76% of the shares of Tbilgazi. The MSPM's tender announcement stated a selling price of US\$6 million and required the purchaser to invest not less than US\$30 million within 2 years for rehabilitation and development of the gas distribution system. In August 1998, the MSPM approved Intergaz (later renamed Sakgaz) as winner of the commercial tender. Subsequent discussions between the MSPM and Sakgaz related to the level of debt assumption by Sakgaz led to non-payment of the purchase price and the MSPM cancelled the tender award in February 1999.

This offering follows the successful privatization of Telasi, the electric distribution company serving Tbilisi, in late 1998. The Telasi privatization, conducted by the MSPM with assistance from the investment bank Merrill Lynch, is the largest and most recent energy sector privatization in a program that began in 1994. AES Corporation, an owner and operator of electric generation facilities throughout the world, was the successful purchaser of Telasi.

1.2. Tender Process

The Tbilgazi privatization will be conducted via a two stage bidding process and will be concluded in an expeditious manner. Potential Investors will be required to submit a formal qualification application in order to bid for Tbilgazi.

If the formal qualification application is accepted by the MSPM, Investors will be invited to conduct detailed due diligence on the Company in Tbilisi, Georgia. The due diligence process will include, without limitation, meetings with senior officials of the MSPM and the Company, review of data room materials and inspection of physical facilities.

Potential Investors will be invited to submit non-binding offers for the purchase of Tbilgazi on or before August 30, 1999. The MSPM will then evaluate the non-binding offers, and the tender will be formally announced on September 10, 1999. Final binding offers for Tbilgazi will be accepted by the MSPM between September 29 and October 28, 1999. The Tender Commission will open the final binding offers on October 29, 1999 and expects to announce the tender results by November 4, 1999.

The MSPM expects to conclude the transaction with the successful Investor no later than November 29, 1999.

Investors should refer to the Request for Formal Proposal for additional information on the privatization process, including the evaluation criteria for offers. Proposals will be evaluated primarily on the basis of cash consideration, level of debt assumption, future investment and system rehabilitation commitments, a clear long-term commitment to customer service, and the experience and expertise of the Investor in owning and operating natural gas distribution systems. The Government of Georgia and the MSPM expressly reserve the right to reject any or all offers for Tbilgazi without providing the reason or reasons therefor.

1.3. Business Overview

Tbilgazi purchases, transports, and distributes natural gas to residential customers, commercial and industrial enterprises and State-owned entities in Tbilisi, Georgia. Tbilgazi, founded as a State-owned enterprise in 1958, was reestablished in 1997, as a JSC owned by the Government.

Sector, system and customer attributes are described in detail in Sections II and III of this Memorandum. In 1989, prior to the disruption of gas supplies to Tbilisi and attendant deterioration of the distribution system, the Company delivered 2.02 bcm of natural gas per annum to nearly 300,000 customers in its service area. Natural gas was delivered to 290,700 residential customers, 240 commercial enterprises, 598 communal customers, and 96 rayon and residential heating boilers.

The recent unbundling of the Georgian natural gas sector, economic and political stability, and a strong political commitment to economic reform and attraction of foreign capital combine to provide the private Investor with a unique opportunity to invest in a Company with tremendous growth potential.

1.4. Georgia - Facts and Investment Climate

1.4.1. Geography, History and Demographics

Georgia is located in the southern Caucasus and is bordered by the Russian Federation, Azerbaijan, Armenia, Turkey, and the Black Sea. Georgia's landmass approximates 69,700 square kilometers, which includes external boundaries of 1,460 kilometers, and a Black Sea coastline of 310 kilometers.



Georgia's recorded history dates to the 6th century BC. In the centuries that followed, Georgia warred with and was, on many occasions, occupied by Persian, Arab, Mongol and Turkish invaders. Georgia's association with Russia began via a protectionist treaty in 1783 that was followed by a Russian annexation of Georgia in 1801. Following a brief period of independence, Russian Bolsheviks once again annexed Georgia in 1921. In 1922 Georgia became a member of the Transcaucasian Socialist Federation, and in 1936 Georgia became a republic of the Soviet Union.

At the end of 1998, the total population was officially estimated at 4.8 million with over 2.0 million people residing in the eight largest cities. The capital city of Tbilisi is located in the southeast part of the country and has a population of approximately 1.4 million people or over 25% of the country total. Other major population centers include Kutaisi (240,000), Rustavi (158,000), Batumi (137,000) and Gori (70,000).

Approximately 70% of the population is Georgian. The largest ethnic minorities include Armenians 9%, Russians 6% and Azerbaijanis 6%. The remainder of the population is comprised of other ethnic minorities.

The predominant religion of the Georgian community is Orthodox. In addition to Christianity, the Islamic and Jewish and other religions are also represented in Georgia.

The climate in Tbilisi is considered continental. Average temperatures range from 0 to 2 Celsius in winter, 7 to 11 Celsius in spring and 21 to 24 Celsius in summer.

1.4.2. Post Soviet Political History

In November of 1990, Georgia held its first democratic parliamentary elections with the Round Table alliance led by Mr. Zviad Gamsakhurdia winning a majority of votes. Georgia declared independence in April 1991 and, in May, Mr. Gamsakhurdia was elected as the first President of independent Georgia. Following the declaration of independence and presidential elections, Georgia underwent a period of political instability and civil unrest.

Opposition to the policies of President Gamsakhurdia led to a two-week civil war in Tbilisi during December and January of 1991-1992. The conflict ended with the departure of President Gamsakhurdia and the return of Mr. Eduard Shevardnadze to Georgia in March of 1992 to become Chairman of the State Council. In October 1992, elections were held and Mr. Shevardnadze was elected Chairman of Parliament and Head of State.

Regional succession movements led also to arm conflict in Tskhinvali (South Ossetia) and Abkhazia during 1991, 1992 and 1993. Armed hostilities in Abkhazia ended in late 1993, and Government efforts to negotiate a political resolution have moved forward slowly.

Following adoption of a new constitution in August 1995, national elections were conducted in November with Mr. Shevardnadze being elected as the second post Soviet-era President.

President Shevardnadze's Government has been diligent in developing structural reforms and pursuing a program of economic stability. The Government has initiated a wide range of programs directed towards commercialization and privatization of State-owned enterprises and development of a transparent legal and regulatory framework for economic activity. The effort to promote economic stability and transition to a market economy has received the support of many western countries and numerous donor organizations including the United States Agency for International Development, World Bank, International Monetary Fund, European Union and the European Bank for Reconstruction and Development.

1.4.3. Government Structure

Post Soviet Georgia has adopted a presidential republic form of government. The new Georgian Constitution was ratified in 1995 prior to the national elections and segregates government into three branches; executive, legislative and judicial. Parliamentary elections are conducted every four years and presidential elections are held every fifth year. The next parliamentary elections are scheduled in November 1999, and will be followed by a presidential election in November 2000.

The Constitution specifies the executive powers of the President of Georgia. The President may exercise executive power directly or indirectly through a number of established Government agencies. The 1997 Georgian law "On the Structure and Activities of Executive Power" refined the structure and function of executive government and created the State Chancellery, twenty-one ministries, eighteen state departments and two state inspectorates.

Legislative authority is vested in Parliament, comprised of 233 members. The Constitution gives the President, Members of Parliament and factions the right to initiate legislation. Holding a referendum to adopt or abrogate a law is prohibited. The current majority party is the Citizens Union of Georgia, a union of politically and ideologically mixed groups that support President Shevardnadze's program of economic and market reform. The Citizens Union won 108 seats in the 1995 elections.

The Constitution separates an independent judiciary from the other two branches of government. The judiciary in Georgia is governed by the Constitution, the 1996 organic law "On the Constitutional Court" and the 1997 organic law "On General Court System in Georgia." The highest court in Georgia is the Supreme Court whose three justices are appointed by the President. The Constitutional Court, established in 1996, is comprised of nine justices, three members each appointed by Parliament, the President and the Supreme Court. The judicial system is generally considered by western standards to be underdeveloped. Recently, the Government has undertaken a program of judicial reform resulting in the adoption of a certification program and the recent appointment of 178 new judges.

1.4.4. Investment Climate

Georgia's program of economic recovery has resulted in a gradual revision of the legal and regulatory framework to promote foreign investment by encouraging transparency, simplification of foreign investment requirements, and providing protection against future changes in legislation.

The legislative framework affecting foreign investment includes the Constitution, the Tax Code, the Civil Code, the Law on Entrepreneurs, the Law on Promotion and Guarantees of Investment Activity, and the Law on Privatization of State Property. The 1999 Georgian Law on Electricity and Natural Gas will be of particular importance to potential investors. The recent legislation dealing with electricity and natural gas is discussed in Section 2.6 of this Memorandum.

The 1994 Law on Entrepreneurs grants private entities the basic right to establish business enterprises and generate profit. The law also sets forth various forms of approved private enterprise structures including individual enterprises, joint liability companies, limited liability companies, joint stock companies, and cooperatives. The law includes general provisions related to governance, registration, accounting, records and liquidation, and includes certain requirements specific to individual forms of enterprise.

The 1997 Law on Promotion and Guarantees of Investment establishes a framework for foreign and domestic investments, provides certain guarantees for their protection, and contains registration requirements for investments over US\$100,000. The law provides foreign investors a level of protection against legislative changes and the uncompensated taking of privately owned assets by the State. The legislation also grants foreign investors the right of conversion and repatriation of profits and certain other assets related to the investment.

One of the main components of the Government's strategy of economic recovery centers upon redevelopment of international trade routes between Central Asia and continental Europe. Established transportation links will increase direct revenue to the Government and, importantly, are likely to facilitate indirect trade and investment in Tbilisi creating economic expansion.

This effort achieved a milestone in April 1999 when the "early oil" pipeline from the Caspian Sea across Georgia to the Black Sea port of Supsa began operation. Rehabilitation of existing facilities and the construction of new pipeline were affected through a joint effort of Georgia International Oil Corporation and Azerbaijan International Operating Company, a consortium of several international oil companies operating in the Caspian region. Efforts continue between the Governments of Georgia, Azerbaijan and Turkey to establish an "east-west" main export pipeline from Baku, across Georgia and Turkey to the Mediterranean port Ceyhan.

In October 1998, Turkey and Turkmenistan signed an intergovernmental protocol for the supply of Turkmen gas to Turkey. More recently, a consortium (named PSG International) between Bechtel Corporation and GE Capital was formed and has signed a contract with the Turkmen government to develop a Trans-Caspian natural gas pipeline from Turkmenistan across Azerbaijan and Georgia to Turkey. Realization of this long-term project is of strategic importance to the future development of the natural gas sector in Georgia.

In the trade arena, Georgia's application to join the World Trade Organization continues to move forward. In late 1988, Japan became the first country to sign a protocol reflecting the successful conclusion of bilateral negotiations with Georgia concerning obligations on tariffs and trade policy. Georgia has adopted many of the legislative changes required for WTO membership and has concluded negotiations with a number of other countries required for World Trade Organization membership. Sources familiar with the process indicate that accession to the organization may occur in late 1999.

2. KEY INVESTMENT CONSIDERATIONS

2.1. The Georgian Natural Gas Sector

Construction of the Georgian natural gas pipeline network began in early 1958, and gas from Azerbaijan reached Tbilisi in 1959. See Section 2.3 of this Memorandum for a description of the main pipeline network.

By 1989, natural gas had become the single most important energy source for the Georgian economy, supplying nearly 62 percent of Georgia's energy needs. Historically, gas supply in Georgia under Sakgaz was nearly ubiquitous; 46 cities and 230 villages had access through local distribution points, as did more than 800 industrial facilities, and about 3,500 communal installations.

Following the breakup of the former Soviet Union, the price of imported natural gas in Georgia increased substantially. The inability of Georgia to pay for gas deliveries resulted in significant internal and external debt, and a near total interruption of supply. Lack of natural gas and electricity has in turn resulted in a reduction of enterprises producing export commodities, which provided currency to pay for imported energy. Moreover, the reduction in gas supply and years of minimal investment has resulted in a deterioration of system facilities. Thus, gas consumption has dropped from a high of over 6.0 bcm in 1989 to an estimated 0.7 to 0.9 bcm per annum in 1996, 1997 and 1998.

Currently, the natural gas sector is composed primarily of companies either wholly owned by the Government either as a State-owned enterprise or JSC. Georgian International Gas Company ("GIC") was established by Presidential Decree in 1997 as a JSC for the purpose of managing Georgia's main natural gas pipeline network, and to represent the State in contracts and negotiations on gas imports

with foreign suppliers. Saktransgazmretsvi was established as a State-owned enterprise in 1996 by Order of the Minister of Fuel and Energy as a successor entity to the Department of Sakgaz and Saktransgaz. GIC is now responsible for the transport and sale of natural gas, and the day to day operation of the pipeline system.

In 1996, responsibility for the management of local gas distribution was conveyed to municipal governments in each locality. The State retained ownership of the distribution systems and the capital stock of each distribution company. As earlier mentioned, in January 1998 the Government began the process of privatizing several of the larger municipal gas distribution companies in Georgia. This effort resulted in the sale of a controlling interest in the municipal distribution companies Kutaisgazi, Bolnisi-gazi, Rustav-gazi, Marneuli-gazi, Kaspi-gazi and Gori-gazi. Intergaz (now Sakgaz), a Georgian subsidiary of Interpak, purchased all six distribution companies as well as controlling interest in the Rustavi cement plant, a major gas consumer.

2.2. Industry Regulation

2.2.1. Regulatory Authority

One of the most important developments in the Georgian energy sector in the post-Soviet era was enactment of the Georgian Electricity Law in June 1997. Significant features of the Electricity Law include:

- creation of the Georgian National Electric Regulatory Commission, renamed the Georgian National Energy Regulatory Commission in 1999, (GNERC or Commission), an independent regulatory agency with comprehensive jurisdiction over the rates, terms and conditions of service of electricity sector enterprises; GNERC has three full time Commissioners appointed by the President of Georgia
- establishment of a system of licenses and tariffs to regulate the operation of electricity sector enterprises, with different requirements for generation, transmission, dispatch, and distribution licensees

During its first full year of operation in 1998, GNERC began to set in place the framework for efficient regulation of the electricity sector. The Commission has:

- issued interim licenses for electricity sector enterprises
- issues interim rates for certain generation facilities
- adopted a tariff methodology for cost based rates
- developed model licenses for generation, transmission, and distribution licensees
- adopted an interim rate increase to 6 tetri per kWh (from 4.5 tetri), pending completion of longer term rate proceedings

2.2.2. 1999 Amendments to the Electricity Law

Amendments to the Electricity Law, including major provisions dealing with natural gas regulation, were enacted by Parliament and signed by the President in May of 1999. The Law, as amended, is now known as the Law on Electricity and Natural Gas. The amendments dealing with natural gas establish GNERC as the sole regulatory authority for the domestic natural gas sector in Georgia and create a system of regulation for the gas supply, transportation and distribution functions.

2.2.3. Licensing Regime

Under the new Law, each entity involved in the supply, transportation and distribution of natural gas within Georgia is required to have a license issued by GNERC. The Commission is authorized to grant three types of natural gas licenses: supply, transportation, and distribution.

Natural gas supply licenses issued by the Commission will authorize the licensee to purchase volumes of natural gas for transfer to distribution licensees and other customers. The Commission is authorized to gas and impose terms and conditions of service.

Gas transportation licenses will authorize the licensee receive deliveries of natural gas and to provide transportation services to one or more distribution licensees, direct customers or delivery points. Transportation licensees are authorized to hold supply licenses as well. Again, the Commission is authorized to regulate the rates, terms and conditions of service.

Natural gas distribution licenses issued by the Commission will grant a license holder the right to distribute natural gas to consumers within a defined geographic or distribution area. As in the case of supply and transportation, the Commission is authorized to regulate the rates, terms and conditions of service.

2.3. Natural Gas Pipeline Network

Georgia International Gas Pipeline Company is the owner of the main natural gas transmission system, and arranges transportation of imported gas to municipalities, certain industrial customers, as well as transit gas to the Armenian border. Pursuant to the terms of a management contract, Saktransgazmretsvi operates the pipeline system. Approximately half of the cities in Georgia currently receive at least partial gas supply including Tbilisi, Kutaisi, Gori, Kaspi, Rustavi, Marneuli and Bolnisi.

The main natural gas pipeline system comprises a network of pipelines 1940 kilometers in length, some of which is in need of significant rehabilitation. There are two main transit lines: a 1,200 mm diameter mainline connecting Georgia to Russia and a 1,000 mm diameter line to Armenia and Azerbaijan. The design capacity of the main system is reported to be 20 bcm, that of the North Caucasus – Trans Caucasus line is 16.4 bcm and that of the line to Armenia and Azerbaijan is 3.6 bcm. The pipeline specifications are shown in Table 1.

Table 1.

Characteristics of the Georgian Gas Pipeline Network			
Pipeline	Diameter (mm)	Length (km)	Year of Construction
N. Caucasus – Trans Caucasus	1200	135	1988 – 1994
Kazakh – Saguramo	1000	112	1980
Karadakh – Tbilisi	800, 700, 500	110	1959 – 1968
Vladikavkaz – Tbilisi	700	266	1963 – 1966
Saguramo – Kutaisi	700, 500	370	1967 – 1975
Kutaisi – Sukhumi	700, 500	338	1986 – 1989
Rustavi – Telavi – Jinali	500, 300, 200	370	1969 – 1975
Krasny Most – Tsalka – Alastan	500, 300	180	1978 – 1990
Gomi – Khashuri – Bakurani	500, 300	59	1972 – 1989

The age of the pipeline network, reduced usage, and lack of routine maintenance due to financial constraints have combined to result in deterioration of the pipeline and related facilities. The system is in need of significant rehabilitation including work related to the repair and replacement of existing pipe, anti-erosion measures, and the repair or replacement of corrosion protection, communication, and metering facilities.

2.4. Gas Supply

Historically, Georgia has received natural gas supply from Azerbaijan, Russia, Iran and Turkmenistan. In the late 1980s Georgia began receiving natural gas from Turkmenistan; these deliveries were curtailed in 1995 due to non-payment.

Currently, Itera International Energy, LLC delivers natural gas to the Georgia's northern border via the North Caucasus. Tbilgazi purchases natural gas directly from JSC Sakgas with transportation services provided by Saktransgazmretsvi. The purchase contract expires December 31, 1999. The contract price is GEL 198.25 per mcm, inclusive of taxes. Current tariffs and collections are discussed in Sections 3.2 and 5.2 of this Memorandum.

Table 2 sets forth the monthly volumes of natural gas delivered to Tbilgazi during 1998.

Table 2.

1998 Tbilgazi Monthly Volumes (mcm)		
Month	Purchased for Resale	Transported Volumes
Jan	7187.4	-
Feb	7189.9	-
Mar	6071.4	-
Apr	4749.0	-
May	4056.0	443.0
Jun	3676.0	-
Jul	3427.8	33.2
Aug	3639.0	2100.0
Sep	3826.4	2037.8
Oct	4349.1	1877.9
Nov	6200.0	1714.0
Dec	8400.0	2744.0
Total	62772.0	10949.9

Source: Tbilgazi Management

Current tariffs and customer categories are discussed in Section 3.2 of this Memorandum.

2.5. Competition

Use of propane for cooking and, to a lesser extent, residential heating is relatively common in Georgia. Estimates of imported propane range as high as 100,000 metric tons per annum. Retail prices in Tbilisi are currently in the 10 to 12 GEL range per 10 kilograms. Private companies engaged in the importation and sale of propane are, depending upon the source, reported to have a market share of 50 to 90 percent of the trade. Sakthevadgazi a State-owned enterprise engaged in storing, transporting and distributing propane imported approximately 16,000 metric tons during 1988. Sakthevadgazi operates ten storage depots with an estimated capacity of metric tons.

3. ASSET DESCRIPTION AND CUSTOMER INFORMATION

3.1. Distribution System

Tbilgazi's gas distribution system is 1,935 kilometers in length, approximately 82% of which is underground. A map of the distribution is included as an exhibit to this Memorandum.

The pipeline system consists of 198 kilometers of high-pressure (to 12 bar) pipe, 551 kilometers of medium-pressure (to 3 bar) pipe, and 1,186 kilometers of low-pressure (to .03 bar) pipe. The system is depicted in Table 3 by diameter for each category of pipe.

Table 3.

Number	Diameter	Above Ground - km			Below Ground - km			Total
		High Pressure	Medium Pressure	Low Pressure	High Pressure	Medium Pressure	Low Pressure	
1	700 mm	0.5	-	-	18.5	-	-	19.0
2	500 mm	9.5	1.5	-	135.5	4.5	-	191.5
3	400 mm	4.0	2.5	-	30.0	20.5	-	57.0
4	300 mm	-	3.5	-	-	11.0	-	14.5
5	250 mm	-	4.0	10.0	-	9.0	11	34.0
6	200 mm	-	3.5	15.0	-	5.5	14.0	41.0
7	150 mm	-	9.0	26.0	-	82.0	31.0	148.0
8	100 mm	-	111.0	65.0	-	194.0	884.0	1254.0
9	80 mm	-	3.0	40.0	-	18.0	29.0	90.0
10	70 mm	-	3.0	25.0	-	15.0	21.0	64.0
11	50 mm	-	2.0	5.0	-	5.0	10.0	22.0
TOTAL		14.0	146.0	186.0	184.0	405.0	1000.0	1935.0

Source: Tbilgazi Management

In 1989, Tbilgazi received natural gas from three main distribution stations, and gas pressure to the system was regulated by 7 gas-regulating stations, 1 automatic regulating station, two hundred sixteen gas regulating facilities, and one hundred ninety-five case type regulating facilities. Eight hundred sixty nine units provided electric-chemical protection to the system. Gas supply was provided to customers via 2 main distribution stations.

Currently, gas is supplied via 1 main distribution station, 2 of the gas regulating stations are in use, and sixty-nine of the regulating facilities are operational. Only 6 of the anti-corrosion units are functional.

Investors should make their own assessment concerning the current status and rehabilitation requirements of the distribution system.

3.2. Current Tariffs and Customer Information

Tbilgazi collects a tariff of GEL .288 per cubic meter, or GEL 288 per mcm, from metered customers. Unmetered residential customers are charged a monthly tariff of GEL 12.10 per connection. Administrative decisions by the Tbilisi Municipality Board have resulted in subsidized natural gas purchases by unmetered customers and small bakeries at a tariff rate below Tbilgazi's cost of gas.

In 1998, Tbilgazi transported approximately 11,000 mcm of gas to Tbilisi Electricity Central. Tbilgazi receives a distribution fee of 90 GEL per mcm that is currently booked as an offset on debt owed to JSC Sakgas.

Tbilgazi's 1998 gas supply by customer category is set forth in Table 4.

Table 4.

1998 Monthly Gas Service by Customer (mcm)							
Month	Industrial	Local Budget	Central Budget	Population	Other	Leakage	Population - excess
Jan	1584.6	172.2	229.4	1197.3	423.6	1495.1	2085.2
Feb	1429.6	86.0	251.4	1257.5	349.7	1526.7	2289.0
Mar	1656.3	64.0	178.0	995.7	305.8	1293.0	1578.6
Apr	1660.3	9.0	66.2	1053.0	132.6	1016.9	811.0
May	1564.9	16.3	33.2	870.7	138.1	987.5	445.3
Jun	1509.9	11.0	31.5	748.8	142.9	1231.9	0
Jul	1486.3	6.0	38.8	702.4	140.2	1054.1	0
Aug	1355.5	6.2	22.5	695.6	154.6	1404.6	0
Sep	1506.8	14.5	26.1	733.9	183.3	1361.8	0
Oct	1577.9	4.0	24.2	799.3	229.7	1714.0	0
Nov	1475.1	13.3	79.9	941.7	337.8	2347.3	1251.1
Dec	1040.5	44.7	227.3	1272.7	499.0	3428.3	233.9
Total	17847.7	447.3	1203.5	11268.6	3037.3	18861.2	10106.4

Source: Tbilgazi Management

3.3. Potential for New Customer Service

In 1989, Tbilgazi delivered approximately 2.0 bcm of Natural gas to nearly 300,000 customers. Residential and industrial customers accounted for approximately 48% of the delivered volumes. Gas delivered to district heating systems approximated 49% of the total.

Table 5 depicts 1989 Tbilgazi customers by category and delivered volume.

Table 5.

1989 Tbilgazi Consumers			
Customer Type	Number of Connections	Delivered Volume (BCM)	Percent of Total
Industrial	246	0.50	24.75
Municipal Entities	598	0.06	2.97
District Heating	96	1.00	49.50
Residential	290,700	0.46	22.77
Total	291,604	2.02	100.00

Source: Tbilgazi Management

It is apparent that Tbilgazi has been unable to leverage off its extensive and potentially attractive residential customer base. This inability is reflected by the Company's inability to pay suppliers and relatively high commercial losses, both of which have affected the company's cash flow and profitability.

Natural gas service has been restored to approximately 41,000 residential units in Tbilisi. Tbilgazi currently delivers gas to approximately 23,400 residential customers, representing approximately 14% of the residential market.

Table 6 depicts current residential connections by method of billing and connection status.

Table 6.

Apartments Connected to the Distribution System – May 1999						
District	Total Apartments	Customers without Meters	Customers with Meters	Disconnected (non-payment)	Temporarily Disconnected (non-payment)	Total Residential Units Receiving Gas
Right Bank						
Total	15,714	1,403	10,877	2,531	893	12,290
Dighomi	3,366	671	1,743	523	429	2,414
Vake	7,022	307	5,314	1,270	131	5,621
Saburtalo	2,888	60	2,287	462	19	2,347
Mtatsminda	1,250	9	1,038	205	7	1,047
Krtsanisi	1,238	356	504	71	303	860
Left Bank						
Total	25,326	1,513	9,585	6,794	7,432	11,098
Gldani	5,542	23	949	2,000	2,570	972
Nadzaladevi	8,253	78	2,689	1,780	3,706	2,767
Chugureti	2,572	194	1,865	275	238	2,059
Didube	2,697	59	1,970	408	260	2,029
Isani	1,931	143	1,318	383	87	1,461
Samgori	4,331	1,016	794	1,950	571	1,810
Total	41,040	2,916	20,472	9,327	8,325	23,388

Source: Tbilgazi Management

While it is unlikely there will be any meaningful rehabilitation of district heating stations, there is significant upside potential for natural gas to be used by residential and commercial customers for space heating, hot water generation and cooking.

Currently the main fuels being used by the population for heating are kerosene, propane and wood. Many large consumers of heat such as government buildings, universities, and private commercial enterprises have installed their own hot water heating boilers utilizing diesel oil, and have disconnected their units from the district heating system. Many of these customers are likely to switch to natural gas when continuous supply is assured.

3.4. Potential for Improvement - Distribution System and Collections

Tbilgazi suffers from significant lost volumes of natural gas due to leakage resulting from deterioration of the distribution system. Technical leakage or outright theft during 1998 accounted for 18,861 mcm or approximated 25% of total volumes.

In 1998, Tbilgazi recorded GEL 5.22 million in customer collections. Approximately 2.46 million GEL, or 47% of the total, is recorded as either an offset or barter transaction. Customers in this category include residential units consuming unmetered gas in excess of established norms, central and local budget entities, subsidized bakeries, and Tbilisi Electricity Central. Privatization of Tbilgazi and implementation of the Law on Electricity and Natural Gas should work to eliminate these transactions.

3.5. Metering, Billing and Collections

The methods of payment for gas deliveries may be generally classified as either cash or non-cash. Cash payments include cash paid directly to the Company and bank transfers. Non-cash payments include various types of settlements, offsets, and barter transactions that frequently involve State and local budget entities and State-owned enterprises.

Cash payments are the predominant method of payment for most residential customers. Inspectors, who are employees of the Company, make monthly visits to the residential units and are responsible for simultaneously performing the metering, billing and collection functions.

Banks transfers are deposits made by customers to a designated Tbilgazi bank account. When the Company is notified of the deposit appropriate credits are made to the customer account. The bank transfer method is used by many of the non-budget industrial and commercial accounts, and generally involves transactions of higher monetary value.

Mutual settlements and offsets currently represent an unacceptably high level of Tbilgazi's collections. In 1998, settlements, offsets and barter transactions accounted for GEL 2,465,754 or nearly 47% of total collections.

Settlement and offset transactions are typically between the Company and either State or local budget entities and State-owned enterprises. The transactions may be concluded either directly with the entity or through one or more intermediaries, and result in a reduction of outstanding debt between the parties without the actual transfer of cash. Payments for natural gas consumption by budget organizations are normally completed by mutual settlement involving the appropriate budget accounts.

3.6. Distribution License and Tariffs

The Georgian National Energy Commission will issue the successful investor a comprehensive license to distribute natural gas within its service area.

In addition to issuing supply, transportation, and distribution licenses, the Commission is authorized to regulate the rates, terms and conditions of distribution service. The Commission is currently developing a tariff methodology that will allow for cost recovery and a reasonable rate of return for licensees. Cost elements are likely to include cost of purchased gas, capital costs, operating expenses, taxes, bad debt allowances, a reasonable allowance for technical losses, and debt service.

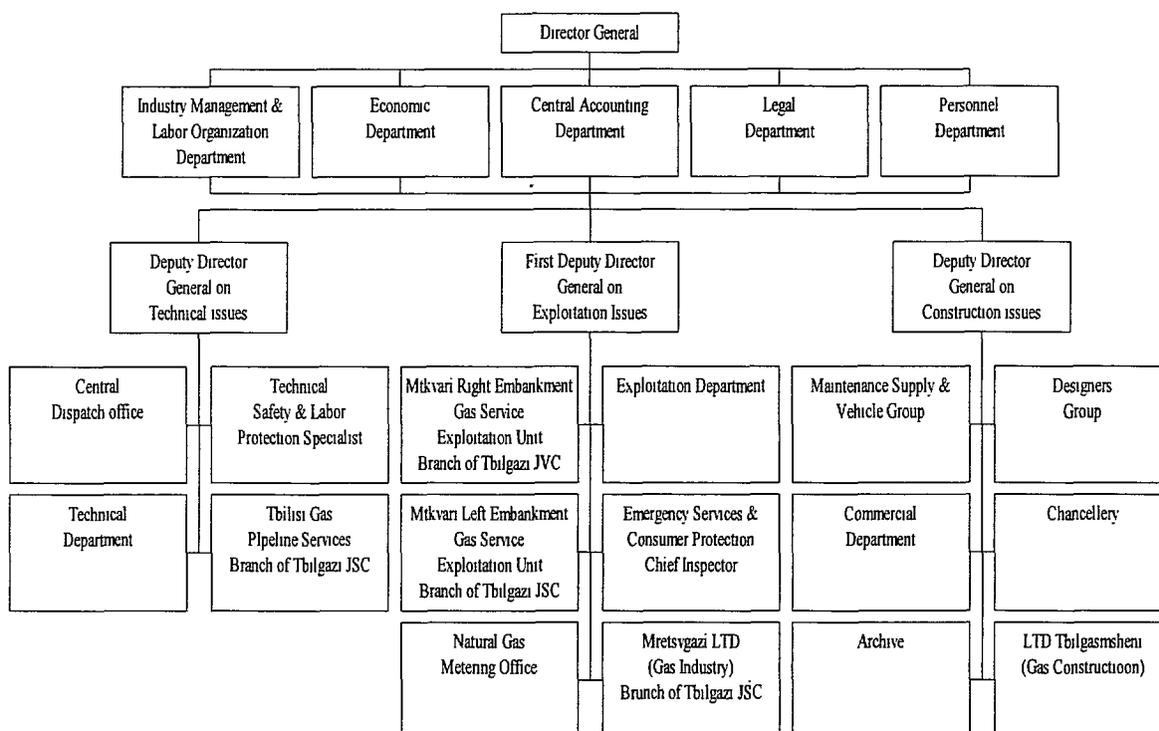
Potential investors should pay particular to the 1999 Law on Electricity and Natural Gas included as an exhibit to this Memorandum.

4. TBILGAZI ORGANIZATION AND MANAGEMENT

4.1. Organizational Structure

Tbilgazi is currently organized into four principal divisions each comprised of several units or departments. There are five administrative departments reporting directly to the General Director.

Tbilgazi JSC



Source: Tbilgazi Management

4.2. Senior Management and Staff

Tbilgazi's senior management is uniquely qualified to assist the Investor in realizing the Company's potential value and in rehabilitating of the distribution system. Table 7 provides a summary of the professional qualifications and experience of senior management.

Table 7.

Tbilgazi Senior Management	
Name & Position	Professional Experience
Valeri Chakhnashvili General Director	<ul style="list-style-type: none"> ➤ Manager, General Director since 1996 ➤ Deputy Chairman of Sakgazi 1993 to 1996 ➤ Manager of various organizations 1971 to 1993
Avtandil Gobechia First Deputy General Director	<ul style="list-style-type: none"> ➤ First Deputy Director since 1998 ➤ State Committee on Gasification 1983 to 1998 ➤ Tbilgazi employee 1960 to 1982
Otar Shengelia Deputy General Director	<ul style="list-style-type: none"> ➤ Deputy Director – Construction since 1995 ➤ Tbilgazi employee since 1964
Tengiz Arshilava Deputy General Director	<ul style="list-style-type: none"> ➤ Deputy Director of Technical Department since 1997 ➤ Engineer for Tunnel Construction 1981 to 1983
Otar Sisauri Head, Economic Department	<ul style="list-style-type: none"> ➤ Head of the Economic Department since 1997 ➤ Sakgazi employee 1970 to 1997
Maia Khutsishvili Head, Accounting Department	<ul style="list-style-type: none"> ➤ Head of the Accounting Department since 1996 ➤ Tbilgazi accountant 1983 to 1996

Source: Tbilgazi Management

The Company has approximately 736 employees. The distribution of personnel by broad category is shown Table X.

Table 8.

Tbilgazi Employees	
Category	Employees
Management Staff	63
Technical Specialists	214
Building Staff	11
Blue Collar Staff	448
Total	736

Source: Tbilgazi Management

4.3. Security Ownership

In 1996 responsibility for the supervision of Tbilgazi was transferred to the Tbilisi municipal government. The State, however, through the MSPM retained ownership of the distribution system and the capital stock of the Company.

5. FINANCIAL PERFORMANCE

5.1. Summary

Tbilgazi is insolvent as demonstrated by its inability to fully pay for gas supply, service debt or fund capital improvement projects necessary to rehabilitate the distribution system. Inadequate tariffs, offsets, and excessive technical and commercial losses have combined to prevent the Company from pursuing even the most modest programs of system maintenance and repair.

Although we have attached Tbilgazi's unaudited balance sheet and income statement for 1996, 1997 and 1998 as exhibits to this Memorandum we have not undertaken a detailed review or analysis of the financial statements. Given the current low utilization rate of the system, high level of offset collections and inadequate tariffs, any restatement of the financial statements according to International Accounting Standard is likely of little value in evaluating the enterprise.

5.2. 1998 Financial Data

Table 9 depicts Tbilgazi payment and collection data for 1998. Given the high level of customer collection via offset transaction, the company 1998 cash flow was negative.

Table 9.

Tbilgazi – 1998 Collections and Payment Data (GEL)					
Month	Customer Collections			Gas Supply Payments	Other Payments
	Cash	Barter	Offset	Cash	Cash
January	309,845	1966	136,047	335,866	11,199
February	313,595	561	205,523	413,053	106,626
March	315,681	983	231,057	444,397	103,324
April	200,900	-	219,744	324,630	96,014
May	212,587	-	206,090	310,377	108,300
June	102,795	-	209,549	215,310	97,034
July	185,024	-	186,722	273,446	98,300
August	204,286	-	143,299	242,495	105,090
September	209,786	2671	175,369	272,626	115,200
October	263,457	-	251,318	396,271	118,504

25

November	161,996	700	265,064	307,560	120,200
December	279,529	2596	226,495	386,220	122,400
Total	2,759,481	9477	2,456,277	3,922,251	1,302,984

Source: Tbilgazi Management

6. LEGAL, SAFETY AND ENVIRONMENTAL

6.1. Legal

According to information provided by management, Tbilgazi is not subject to any claim or litigation material to the ongoing operations of the Company. The Company has, in the past, been subject to local court decisions requiring compensation for damages caused by leakage of natural gas and attendant explosions.

Potential Investors will need to review carefully the debt obligations of the Company, including those to Sakgazi to determine the possibility and extent of contingent liabilities related thereto.

6.2. Safety and Environmental

We have not conducted a safety or environmental review of the distribution system or the internal practices of the Company. Given the age and deteriorated condition of the system, potential Investors should, of course make their own detailed assessment of safety and environmental issues related to the Company.

ATTACHMENT B
DRAFT TBILGAZI REQUEST FOR PROPOSALS

July 1999

Request for Proposals
JSC Tbilgazi
Gas Distribution Company

Tbilisi, Georgia

July 1999

Ministry of State Property Management

A. INTRODUCTION

The Government of Georgia acting through the Ministry of State Property Management ("MSPM") is privatizing certain State-owned enterprises in the natural gas and electricity sector. As part of this continuing program, the Government is offering JSC Tbilgazi, a Georgian company engaged in the distribution of natural gas in Tbilisi, Georgia, for privatization via a competitive process open to domestic and foreign investors.

In January 1998, the Government began the process of privatizing several of the larger municipal gas distribution companies in Georgia. This effort resulted in the sale of a controlling interest in the shares of municipal distribution companies Kutaisgazi, Bolnisi, Rustavgazi, Marneulgazi, Kaspigazi and Gorigazi.

This offering follows the successful privatization of Telasi, the electric distribution company serving Tbilisi, in late 1998. The Telasi privatization is the largest and most recent energy sector privatization in a program that began in 1994. Concurrently with this offering the Government is privatizing a majority of the electricity distribution sub-sector.

The privatization of Tbilgazi offers a strategic investor a unique opportunity to participate in and benefit from the rehabilitation and development of the natural gas sector in Georgia. The Georgian natural gas sector and, in particular, the local gas distribution system within the capital city of Tbilisi has significant growth potential.

B. TRANSACTION STRUCTURE

The Tbilgazi privatization will be conducted via a two-stage competitive bidding process. The Government intends to sell a controlling interest (75%) in Tbilgazi to the private investor. As required by current Georgian legislation, up to ten (10%) percent of the Company's shares will be offered to employees of the Company and, ultimately, the remaining State shares may be offered at auction to the public.

Potential Investors will be required to submit a qualification application and a non-binding offer as provided in Sections D and E of this Request for Proposal.

C. PRIVATIZATION SCHEDULE and PROCEDURE

The competitive sale of Tbilgazi will involve a two-stage bidding process and will be concluded in an expeditious manner.

Potential Investors who express an interest in Tbilgazi will be given an Information Memorandum that gives a general description of the Company, its customer base, and the investment climate in Georgia. The sole purpose of the Information Memorandum will be to assist the recipient in deciding whether to proceed with a further investigation of the Company. The Information Memorandum will not contain all of the information that a diligent Investor will require in investigating the Company. Accordingly, potential Investors should pay particular attention to the disclaimer located at the front of the Information Memorandum.

Bidders will be required to submit a written qualification application to bid for Tbilgazi. See Section D below for requirements of the qualification application.

If the qualification application is accepted by the Ministry of State Property Management, potential Investors will be invited to conduct detailed due diligence on the Company in Tbilisi, Georgia. The period for due diligence will close one day prior to the date final binding offers are due. The due diligence process will include, without limitation, meetings with senior officials of the Ministry of State Property Management and other Government officials, presentations by the Company's senior management, a review of data room materials and an inspection of physical facilities. Potential Investors will be expected to coordinate site visits with the Ministry of State Property Management well in advance of their arrival.

Preliminary non-binding offers must be submitted to the MSPM on or before August 30, 1999. The MSPM will review the non-binding offers and the tender will be formally announced on September 10, 1999. Final binding offers for Tbilgazi will be accepted by the MSPM between September 29 and October 28, 1999. The Tender Commission will open the final binding offers on October 29, 1999 and expects to announce the tender results by November 4, 1999. The MSPM expects to close no later than November 29, 1999. Requirements and conditions related to final binding offers are detailed in Section F below.

D. SUBMISSION OF QUALIFICATION APPLICATION

Potential Investors, who are interested in conducting due diligence, are required to submit a written qualification application to the MSPM. If the qualification request is accepted by the MSPM, Investors will be invited to conduct detailed due diligence in Tbilisi. The qualification letter should include an expression of interest in bidding and a narrative description of the Investor's business activities and previous experience in the gas sector.

Qualification applications should be submitted sent to:

Mr. Mikheil Ukleba
Minister
Ministry of State Property Management
64 Chavchavadze Avenue
380062 Tbilisi, Georgia
Telephone: (995 32) 29 48 75

E. NON-BINDING PRELIMINARY OFFERS

Preliminary non-binding offers must be submitted to the MSPM on or before August 30, 1999 to the attention of Mr. Mikheil Ukleba at the above address. The non-binding offers should include the following:

1. The total cash consideration to be paid at closing of the transaction (stated in US Dollars).
2. The total level of assumed debt (stated in US Dollars).
3. The investment commitments for rehabilitation and development of the gas distribution system (stated in US Dollars).
4. Any stipulations related to the non-binding offer.

F. BINDING OFFERS

Binding offers must be submitted to the MSPM between September 29 through October 28, 1999 at 17:00 local time, Tbilisi, Georgia. The offers must include the following information:

1. The total cash consideration (payable in US Dollars) to be paid at closing of the transaction.
2. The total level of assumed debt (stated in US Dollars).
3. Investment commitments for rehabilitation and development of the gas distribution system (stated in US Dollars and a year by year timing for the first five years).
4. Evidence of the Investor's financial ability to consummate the transaction and fund future investment.
5. The natural gas distribution tariff proposed by the potential Investor.
6. A marked up copy of the Purchase and Sale Agreement provided by the MSPM. The marked up copy should include all changes that the Investor will require in order to execute the Agreement.

Final binding offers which contain financing contingencies, requests for additional periods of due diligence, or mechanisms that trigger adjustments in the consideration based upon other offers will not be considered.

Offers should be submitted to:

Mr. Mikheil Ukleba
Minister
Ministry of State Property Management
64 Chavchavadze Avenue
380062 Tbilisi, Georgia
Telephone: (995 32) 29 48 75

G. EVALUATION OF BINDING OFFERS

The MSPM reserves the right to discuss binding offers with the potential Investor, to negotiate with one or more potential Investors at the same time. Additionally, the Government of Georgia and the MSPM expressly reserve the right to reject any or all offers for Tbilgazi without providing the reason or reasons therefor.

A final binding offer will be accepted when, and only when, a definitive Purchase and Sale Agreement is entered into between the parties. The Investor shall be entitled to rely solely on the representations and warranties, if any, made to it by the Government in any final Purchase and Sale Agreement.

Final binding offers will be evaluated on the basis of:

1. Maximum cash consideration.
2. Level of debt assumption and timing of debt repayment.
3. The proposed gas distribution tariff.
4. The level and timing of investment and system rehabilitation commitments.

The MSPM will also evaluate revisions to the Purchase and Sale Agreement, the potential Investor's commitment to customer service, and the experience and expertise of the Investor in owning and operating natural gas distribution systems.

H. CONTACT INFORMATION

Under **NO** circumstances should the management of Tbilgazi be contacted directly. All communications, inquiries and requests for information relating to the privatization of Tbilgazi **MUST** be addressed to:

Mr. Mikheil Ukleba
Minister
Ministry of State Property Management
64 Chavchavadze Avenue
380062 Tbilisi, Georgia
Telephone: (995 32) 29 48 75