

Russia's Energy Interests in Azerbaijan: A Retrospective Analysis and Prospective View

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Abstract

This article is a deep dive into the reasons behind Russian President Putin's state visit to Azerbaijan, with a specific focus on Russia's energy interests in the region. The investigation includes an analysis of key players such as Gazprom and Lukoil in Azerbaijan, and their future plans for energy cooperation with Russia. The article also evaluates the potential impact of Russia's energy interests in Azerbaijan on Europe's energy security, and the feasibility of Azerbaijan meeting its gas supply commitments to Europe.

Keywords: Russia, Azerbaijan, energy, oil, gaz, Gasprom, Lukoil, SOCAR, ACG, Shahdeniz, SGC, BTC

Introduction

For the first time since launching a full-scale war against Ukraine, Russian President Vladimir Putin has made an official state visit to the South Caucasus, specifically to Baku. The timing of Putin's visit to the South Caucasus is no coincidence, as it occurs amid growing tendencies to distance from Russia in the region, with the Armenian government and the Georgian people increasingly advocating for accelerated integration with the West. Additionally, talks are ongoing regarding the opening of the Armenia-Turkey border.

Among the South Caucasus countries, Azerbaijan was chosen for this foreign visit not only because of its authoritarian leadership's loyalty to anti-Western policies (1) but also due to its strategic geographical position, including access to the Caspian Sea (2), as well as the development of its energy (3) and transportation (4) infrastructure, the volume of trade operations (5), and the volume of investments (6).

The growing negative impact of consecutive sanctions and embargoes imposed on Russia due to its war in Ukraine has been weakening the Russian economy¹, prompting the Putin administration to seek new opportunities in the Global South and East in an attempt to offset the damage caused by the disruption of economic, trade, and financial cooperation with the collective West. In terms of expansion into the South and East, Russia's possibilities are limited beyond Azerbaijan in the South Caucasus and Kazakhstan in Central Asia. Both countries' leadership roles in their respective regions are among the key factors in determining the destinations of Putin's foreign visits. Therefore, the Russian president's visit to Azerbaijan was expected.

As for the goals and outcomes of the visit, while the time frame is short, we will attempt to evaluate them. In my opinion, **the primary reason** behind Putin's visit to Azerbaijan is linked to concerns over the increasing initiatives aimed at disrupting the status quo in the South Caucasus. In particular, recent positive developments in Armenia's bilateral relations with Turkey and Iran, as well as its multilateral relations with the collective West, are causing serious concern for Russia. Undoubtedly, the central theme of the restricted meeting between the presidents of Russia and Azerbaijan in Baku was the use of Azerbaijan's government capabilities to limit the influence² of the collective West in the South Caucasus.

Secondly, the coordination of foreign policy and international cooperation between Russia and Azerbaijan, as outlined in the "Declaration on Allied Cooperation between the Republic of Azerbaijan and the Russian Federation"³, is of particular importance, especially during a period

¹ Ibadoghlu, Gubad (2022), What impact would the EU's Russian oil ban have on the Kremlin? LSE European Politics and Policy (EUROPP) blog (09 May 2022), <https://blogs.lse.ac.uk/europpblog/2022/05/09/what-impact-would-the-eus-russian-oil-ban-have-on-the-kremlin/>

² <https://www.youtube.com/watch?v=HKilRZF1zTc>

³ <https://president.az/az/articles/view/55498>

when Russia's international influence is waning. I believe that joint representation in regional organizations and support for Russia's position in international platforms were among the topics discussed behind closed doors during the limited-format meeting between the heads of state. This is reflected in the joint statement⁴ issued following Putin's visit to Baku, where it was noted that "both parties recognize the important role of the Shanghai Cooperation Organization (SCO) in maintaining peace, security, stability, and sustainable development. Russia supports Azerbaijan's efforts to elevate its status in the SCO and its interest in strengthening cooperation with BRICS." The next day, official Baku submitted its application for BRICS membership, which can be seen as a practical outcome of these discussions. Additionally, the Russian president declared in Baku that he would also support Azerbaijan's membership in the SCO⁵.

Thus, discussions may begin regarding Azerbaijan's potential membership in the Eurasian Economic Union (EEU) and the Collective Security Treaty Organization (CSTO), after joining China-led organizations like the SCO and BRICS. However, the prospects for such discussions seem limited. Firstly, the CSTO is known as an ineffective organization plagued by mutual distrust and lacking solidarity, which has been further eroded by the recent issues in Armenian-Russian bilateral relations. Regarding the EEU, while Azerbaijan prefers bilateral economic relations with Russia⁶, it must proceed cautiously to avoid being affected by Western sanctions. Consequently, at this stage, Azerbaijan's membership in the CSTO and EEU, key instruments for securing Russian interests in the post-Soviet space, is not a priority. Azerbaijan's Membership in the EEU and CSTO is more likely in the event that Armenia halts its relations with both organizations.

Thirdly, one of the main topics Russia discussed with Azerbaijan during their extended meeting⁷ was the expansion of cooperation in the energy sector. The involvement of Russian Deputy Prime Minister Alexander Novak, who oversees the energy sector, and Alexey Miller, Chairman of the Gazprom Management Committee, in these discussions during the visit highlights the importance placed on energy talks, particularly regarding the sale of Russian gas.

⁴ <https://turan.az/az/siyaset/putinin-baki-seferinin-yekunlari-ile-bagli-rusiya-federasiyasi-ve-azerbaycan-prezidentlerinin-birge-beyanati-783735>

⁵ Ibadoghlu, Gubad, Azerbaijan's Membership in BRICS and SCO: Myths and Realities (July 27, 2024). Available at SSRN: <https://ssrn.com/abstract=4907447> or <http://dx.doi.org/10.2139/ssrn.4907447>

⁶ Ibadoghlu, Gubad, Can Azerbaijan Become a Member of the Eurasian Economic Union? (April 22, 2022). Available at SSRN: <https://ssrn.com/abstract=4090794> or <http://dx.doi.org/10.2139/ssrn.4090794>

⁷ <https://president.az/az/articles/view/66705>

Gas cooperation

It is worth noting that even before his visit to Baku, Russian Deputy Prime Minister Alexander Novak told the press⁸ that "we have a very broad range of issues with Azerbaijan in the energy sector. This concerns the development of joint ventures and the participation of Russian companies 'Lukoil,' 'Tatneft,' 'Sibur,' and 'Novatek' in new projects with their Azerbaijani counterparts." For example, the Russian oil company "Tatneft" will jointly develop the "Bibi-Heybat" onshore field with the State Oil Company of Azerbaijan (SOCAR)⁹.

Gazprom CEO Alexey Miller also announced that the Russian gas giant "Gazprom" and SOCAR have agreed to expand their strategic partnership. Miller stated that the mutually beneficial partnership between Gazprom and SOCAR is developing dynamically. "For example, there is the North-South project or the comprehensive scientific and technical program to be signed in September this year. An agreement has been reached to expand the multifaceted strategic partnership," the company's press service quoted Miller as saying¹⁰.

Between 2000 and 2006, Azerbaijan purchased up to 4.5 billion cubic meters of gas from Russia. However, a significant fuel price surge in 2007 compelled the Azerbaijani side to halt further imports. At the beginning of June 2008, the head of 'Gazprom,' Alexey Miller, proposed to the President of Azerbaijan, Ilham Aliyev, to transfer gas to the Russian Federation based on a long-term contract for resale. Since 2007, Azerbaijan joined the ranks of gas exporters, gas supplies from Russia were halted.

On June 29, 2009, 'Gazprom' and SOCAR signed an agreement on the main terms of the purchase and sale of Azerbaijani natural gas, and on October 14, 2009, a purchase and sale contract was signed. The supply of gas to Russia started on January 1, 2010.

Between 2010 and 2014, under a medium-term contract signed between SOCAR and Gazprom, Azerbaijan exported gas to Russia to meet Dagestan's gas demand. During these years, Azerbaijan's gas exports to Russia amounted to at least 500 million cubic meters annually.

In 2015, Azerbaijan's Methanol Plant (AzMeCo) imported gas from Russia for a short period. Later, Gazprom supplied gas to Azerbaijan during the winter months of 2017 and 2018.

⁸ <https://news.az/news/-russian-companies-aim-to-expand-their-presence-in-azerbaijan>

⁹ https://www.azernews.az/oil_and_gas/228582.html

¹⁰ <https://interfax.com/newsroom/top-stories/105223/>

On November 21, 2017, Gazprom Export LLC and SOCAR agreed to restore the supply of Russian natural gas to Azerbaijan. In 2018, 1.15 billion cubic meters of gas was supplied to Azerbaijan under the contract. Between 2019 and 2021, natural gas has not been provided to Azerbaijan. On July 27, 2021, cooperation in the field of seasonal exchange of natural gas (until 2023) between the state company 'Azerkontrakt' (which, from 2021, performs one of the functions of SOCAR on the wholesale purchase and sale of natural gas) and 'Gazprom' contract was signed. The document provided information on the transportation of gas from Azerbaijan to Russia in the summer and the transportation of a similar volume of gas from Russia to Azerbaijan in the winter season (volumes are not disclosed). The technical execution of the contract in terms of acceptance and shipment of the appropriate volume of products from the Azerbaijani side was carried out by the State Oil Company of Azerbaijan.

In 2022, under an agreement signed between Gazprom Export LLC and SOCAR, Azerbaijan resumed gas imports from Russia. On November 15, 2022, under a new gas sales contract, the supply of Russian gas to Azerbaijan began. Under this contract, up to 1 billion cubic meters of gas was delivered to Azerbaijan by March 2023.

According to volumes registered by the State Customs Committee, the value of gas imported to Azerbaijan in 2022 amounted to \$130.634 million, which is 6.7 times higher than the previous year's volume. In 2022, Azerbaijan imported 1 billion 16 million 423.6 thousand cubic meters of gas. Of this, 84.3% (857 million 66.65 thousand cubic meters) came from Turkmenistan, 9.17% (93 million 265.8 thousand cubic meters) from Russia, and 6.53% (66 million 91.19 thousand cubic meters) from Iran¹¹. There was no gas export from Azerbaijan to Russia during that year.

In 2023, 800.6 million cubic meters of gas worth \$143.225 million were imported from Russia to Azerbaijan, including 400 million cubic meters delivered to the Republic of Dagestan. At the same time, under a gas exchange agreement, Azerbaijan exported 326.5 million cubic meters of gas worth \$55.5 million to the Russian Federation. According to customs statistics, Azerbaijan's total gas imports in 2023 amounted to 2.32 billion cubic meters, of which 1.52 billion cubic meters were from Turkmenistan and 800.6 million cubic meters from Russia¹².

On August 19, 2024, although an agreement was reached in Baku between Gazprom and SOCAR to expand their strategic partnership¹³, the details of this agreement were not disclosed by either party. However, it appears that gas sales between Azerbaijan and Russia will now take on a more

¹¹ <https://interfax.az/print/887278/az>

¹² Ibadoghlu, Gubad, Current State of Azerbaijan's Gas Cooperation with Europe: Opportunities and Challenges (August 20, 2024). Available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4931082

¹³ https://azertag.az/en/xeber/_quotgazprom_quot_and_socar_expand_strategic_partnership-3143766

regular nature. It is possible that in the future, Russian gas may be transported to Armenia and Iran via Azerbaijan, or Azerbaijani gas could be exported to the European market through Russia and Ukraine.

For context, pipeline routes are already in place for these scenarios. Gas imports from Russia to Azerbaijan and exports in the opposite direction are conducted through the Hajigabul-Shirvanovka-Mozdok pipeline¹⁴. Since 2007, as gas production in Azerbaijan increased and domestic demand was fully met, this pipeline has not been used intensively. However, between 2010 and 2014, within the framework of agreements for the export of certain volumes of Azerbaijani gas to Russia, the Hajigabul-Mozdok main gas pipeline was used in reverse, to export gas from Azerbaijan to Russia. While the pipeline, operated by SOCAR and Russia's Gazprom, has an annual capacity of 10 billion cubic meters, only around 50% of its capacity is typically utilized at best¹⁵.

The Hajigabul-Gazakh-Saguramo main pipeline¹⁶, operated by SOCAR and Georgia's Gas Transportation Company, was constructed in 1978 and remained in operation until 1988. After the collapse of the Soviet Union, this pipeline remained unused for a long time. Following rehabilitation and repair work, the pipeline was put back into service in 2006. With an annual capacity of 8.7 billion cubic meters, this pipeline could facilitate gas imports from Azerbaijan to Georgia and onward to Armenia. During the Soviet era, gas was also transported to Georgia and Armenia through the Mozdok-Shirvanovka-Hajigabul pipeline.

The new agreement between SOCAR and Gazprom has drawn attention amid discussions about alternative solutions to address the issues surrounding the required investments for expanding transportation infrastructure to increase gas exports from Azerbaijan to Europe. This agreement could potentially reshape the energy geopolitics of the region. Russia and Azerbaijan seem to be jointly planning new options to diversify their gas exports. Even before these plans materialized, after SOCAR's agreement with Russia's Gazprom to expand their partnership, calls for boycotting the Azerbaijani state company's gas stations appeared on social media in Ukraine. Local users argue that Azerbaijan purchases oil and gas from Russia and sells it to Ukraine. For context, SOCAR operates 57 gas stations in Ukraine.

Immediately following the agreement to expand the strategic partnership between Gazprom and SOCAR, Azerbaijan's government-affiliated¹⁷ and pro-Russian¹⁸ media¹⁹ published articles

¹⁴ <https://minenergy.gov.az/az/qaz/cenubi-qafqaz-boru-kemeri-cqbk>

¹⁵ Gubad Ibadoghlu, Can Azerbaijan become a reliable gas supplier for Europe? ECPR's Political Science Blog <https://theloop.ecpr.eu/can-azerbaijan-become-a-reliable-gas-supplier-for-europe/>

¹⁶ <https://minenergy.gov.az/az/qaz/cenubi-qafqaz-boru-kemeri-cqbk>

¹⁷ <https://sherg.az/aktual/271682>

¹⁸ <https://az.sputniknews.ru/20240821/boykot-nesmotrya-na-mnogomillionnyu-pomosch---aktivy-socar-na-ukraine-pod-ugrozoy-466827029.html>

¹⁹ <https://caliber.az/post/261517/>

against official Kyiv in response to a campaign²⁰ by Ukrainian consumers boycotting SOCAR's fuel stations. On May 31, 2024, Palestinian activists in Turkey organized an attack on SOCAR's Istanbul office²¹ due to its fuel sales to Israel. Besides Ukraine and Turkey, SOCAR operates fuel stations under the "SOCAR" brand in Georgia, Romania, Switzerland, and Austria, and under the "A1" brand in Austria²².

²⁰ https://ukranews.com/news/1027999-ukrayintsi-ogoloshuyut-bojkot-zapravkam-socar-na-tli-yih-domovlenostej-pro-rozshirennya-partnerstva#google_vignette

²¹ <https://turan.az/en/politics/socar-office-attacked-in-istanbul-781112>

²² <https://socar.az/en/page/marketing-ve-satis>

Role of Azerbaijan in the European energy security

Prior to the agreement to expand the strategic partnership between Gazprom and SOCAR, Western circles, including foreign media and international rating agencies, raised concerns about Azerbaijan's ability to meet its commitments to European consumers due to inadequate gas reserves. In May 2024, Fitch Solutions predicted²³ that Azerbaijan would increase natural gas imports from Russia to meet domestic demand. Standard & Poor's Commodity Insights²⁴ argued that even if Azerbaijan could realize its current and potential gas projects on time, the country's gas balance would remain extremely strained, and only through imports from Turkmenistan, Iran, and Russia could Azerbaijan comfortably meet the increasing demand from Europe. The Economist Intelligence Unit (EIU) noted²⁵ that Azerbaijan's gas exports to the EU have significantly increased since 2021, but the commitment to double the gas flow to the bloc by 2027 is constrained by infrastructure capabilities and growing domestic consumption. Investment will be required to improve Azerbaijan's gas infrastructure and increase production, as the EU prefers renewable sources and higher volumes of liquefied natural gas (LNG), making it challenging to allocate funds to this sector. Eurasianet reported²⁶ that although export growth is strong, the overall volume is still well below the level needed to fulfill Azerbaijan's promise to the EU to increase gas exports to 20 billion cubic meters per year by the end of 2027. The author suggests that cooperation with Turkmenistan appears to be a viable solution to Baku's export dilemma.

It seems that the agreement to expand the strategic partnership between Gazprom and SOCAR has so far resulted in protests in Ukraine and validation of analysts' expectations. Analysts did not believe that Azerbaijan could meet its commitment to supply 20 billion cubic meters of gas to European buyers by 2027 with domestic resources alone. They suggested that if the infrastructure for gas transit to Europe were increased, Azerbaijan could fulfill its commitment to European consumers by importing gas from Russia, Turkmenistan, and Iran. Due to the lack of gas transit infrastructure between Azerbaijan and Turkmenistan, natural gas from Turkmenistan can only be imported through swap transactions via Iran. This means that Azerbaijan imports natural gas from Iran in the volume exported by Turkmenistan to Iran, and this has been happening since 2022. Gas from Russia and Iran can be supplied to Azerbaijan through existing pipelines (Mozdok (Russia) - Shirvanovka - Hacıqabul and Astara (Iran) - Astara - Hacıqabul²⁷). Currently, the actual throughput capacity of the Mozdok (Russia) - Shirvanovka - Hacıqabul pipeline is a maximum of

²³ <https://sputnik.az/20240502/yalan-nezeriyye-azerbaycanin-rusiya-federasiyasindan-qaz-idxalina-ehtiyaci-varmi-464320346.html>

²⁴ <https://www.spglobal.com/commodityinsights/en/ci/research-analysis/will-azerbaijan-meet-europes-2027-gas-demand-deadline.html>

²⁵ <https://www.eiu.com/n/azerbaijans-gas-exports-to-the-eu-face-challenges/>

²⁶ <https://eurasianet.org/azerbaijans-gas-exports-increase-but-baku-still-challenged-to-meet-eu-goal>

²⁷ <https://minenergy.gov.az/az/qaz/cenubi-qafqaz-boru-kemeri-cqbk>

5 billion cubic meters per year, and the maximum throughput capacity of the Astara (Iran) - Astara - Hacıqabul pipeline is 3 billion cubic meters per year²⁸. The agreement to expand the strategic partnership between Gazprom and SOCAR can be considered a step toward realizing one of the analysts' previously suggested scenarios: importing natural gas from Russia.

The agreement to expand the strategic partnership between Gazprom and SOCAR could discourage European buyers from committing to long-term gas purchases from Azerbaijan. This agreement increases the number of arguments reinforcing the position that Azerbaijan cannot meet its commitments to European buyers solely based on its own potential. The main goal of the EU's natural gas deal with Azerbaijan is to reduce European consumers' dependence on Russia and limit the export capabilities of Russian gas suppliers. The EU has significantly reduced its imports from Russia, managing to come out of the last two winter seasons with ample gas reserves. Consequently, Azerbaijan, which seeks to expand its strategic partnership with Russia in the gas sector, must make decisions regarding its new gas strategy during a period when European buyers prefer LNG²⁹, are rapidly transitioning to renewable energy sources, and have reduced their gas demand by 18% from August 2022 to December 2023, saving approximately 101 billion cubic meters³⁰. Additionally, European underground gas storage levels have exceeded 91% or 100 billion cubic meters³¹, and the trading price of gas on the European exchange has stabilized at around \$420 per thousand cubic meters³². All these factors work against Azerbaijan's current gas strategy and deter European buyers from committing to long-term gas purchases from Azerbaijan. Europe's decreasing dependence on Russia, as it approaches several energy security goals, has been consistently declining. According to Eurostat³³, Russia's share of the EU's natural gas imports fell from 41% in the first quarter of 2022 to 14% in the first quarter of 2024. This threefold decrease has significantly impacted Russian gas exports. While natural gas exports from Russia were approximately 450 million cubic meters per day at the end of 2021, this level has now dropped to about 150 million cubic meters per day³⁴. The remaining gas flows are divided among LNG, pipeline flows through Ukraine, and other pipeline routes (primarily flows from Turkey to Bulgaria, as well as flows from Belarus to Lithuania).

²⁸ Gubad Ibadoghlu, Can Azerbaijan become a reliable gas supplier for Europe? ECPR's Political Science Blog, <https://theloop.ecpr.eu/can-azerbaijan-become-a-reliable-gas-supplier-for-europe/>

²⁹ https://www.agora-energiawende.org/fileadmin/Partnerpublikationen/2023/LNG_Climate_and_Energy_Security_Towards_a_Comprehensive_Approach_for_Europe.pdf

³⁰ https://ec.europa.eu/commission/presscorner/detail/en/ip_24_1142

³¹ <https://sbhcenter.com/en/news/european-gas-reserves-exceed-100-billion-cubic-meters/>

³² <https://www.bloomberg.com/markets/commodities>

³³ https://ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_trade_with_Russia_-_latest_developments

³⁴ <https://oilprice.com/Energy/Natural-Gas/Can-Europe-Survive-Winter-Without-Russian-Gas-Experts-Weigh-In.html>

After 2025, when gas deliveries through Ukraine to the West are expected to stop, Russia's share of the European gas market will further decrease. Although Gazprom has stated that it will continue gas transit through Ukraine, it appears that its agreement to expand the strategic partnership with SOCAR is aimed at preparations for the coming year. According to Ukraine's gas pipeline operator, the transit of Russian gas through Ukraine to Europe decreased by 28.5% from 20.5 billion cubic meters in 2022 to 14.65 billion cubic meters last year. This reduction is part of Europe's strategy to decrease reliance on that pipeline, and Europe is preparing to phase out the use of this route. Therefore, the prospect of filling this pipeline with Azerbaijani gas via Russia and delivering it to Europe seems bleak, as Europe is overall preparing to phase out that pipeline. Reuters reports³⁵ that most EU countries have reduced their dependence on Russian gas due to the invasion of Ukraine. The former main buyers of gas via Ukraine include Austria, Slovakia, Italy, Hungary, Croatia, Slovenia, and Moldova. Austria still receives a significant portion of its gas via Ukraine, while others have diversified their sources and taken steps to reduce demand.

Fighting in the Kursk direction could lead to an early and abrupt cessation of gas transit to Europe via this route. The European Commission has stated that alternative supply sources are available. They believe that Austria could import the gas it cannot get via this route from Italy and Germany. Hungary uses the "TurkStream" pipeline, while Slovenia sources gas from Algeria and other suppliers. Italy receives most of its gas from Azerbaijan and Algeria³⁶.

It appears that the EU is working to diversify its gas imports and has signed an agreement to double Azerbaijan's gas imports to at least 20 billion cubic meters per year by 2027. However, expanding infrastructure, increasing production, and the necessary financing for additional gas supplies from Azerbaijan are still lacking. According to Energy Aspects' analysts³⁷, with growing domestic consumption, there are only about 1.7 billion cubic meters of reserves available for additional exports, which is insufficient to meet the commitment. This means that Azerbaijan might only be able to increase its gas supply to Europe to a maximum of 15 billion cubic meters by 2027, even with gas imports from Russia, Iran, and Turkmenistan.

Thus, the outcome of the agreement to expand the strategic partnership between Gazprom and SOCAR is that Russia is searching for a market to sell a portion of the natural gas it cannot sell to Europe via pipelines in 2025. According to Gazprom, its daily export to Europe through Ukraine is currently more than 40 million cubic meters. Considering that the average price of gas for Europe in 2025 is expected to be \$320 per thousand cubic meters, Russia could lose about \$4.5 billion annually if exports via Ukraine are halted. In this scenario, Azerbaijan could be Russia's best

³⁵ <https://www.reuters.com/business/energy/what-happens-if-russian-gas-transit-via-ukraine-stops-2024-08-08/>

³⁶ <https://www.consilium.europa.eu/en/infographics/eu-gas-supply/>

³⁷ https://x.com/Beefeater_Fella/status/1822016007000711346

partner for increasing gas exports, given the existing infrastructure and political relations between the two countries. Currently, Azerbaijan, which sees no prospects for financial support from the EU, may be compelled to accept Russia's offers.

Oil cooperation

In Azerbaijan, there are 1,270 enterprises operating with Russian capital. Among these, "Lukoil" leads in terms of investment volume. "Lukoil" is the main company representing Russia's energy interests in Azerbaijan's oil sector. "Lukoil" is involved not only in exploration, production, and transportation within Azerbaijan's oil sector but also in marketing and sales activities. Since 1993, the "Lukoil" Group³⁸ has been represented in Azerbaijan's retail fuel market with 63 gas stations and one oil depot with a storage capacity of approximately 6,400 cubic meters³⁹. "Lukoil" is also the dealer of LLK-International LLC, the first supplier of lubricants and technical fluids in Azerbaijan. The company is a reliable supplier of diesel fuel, automobile gasoline, and lubricants to large international and Azerbaijani companies operating in the local market, holding a 10% share in the sale of oil products in the Azerbaijani market. "Lukoil" also engages in the sale of its motor oils in the local retail market, with its EKTO-branded fuel accounting for 98% of retail sales. "Lukoil-Azerbaijan" Open Joint Stock Company was also the founder of the Nikoil investment bank, which operated in Azerbaijan⁴⁰. The company holds a 19.99% stake in the development of the "Shah Deniz" field and a 25% stake in the "Shallow Water Absheron Peninsula" (SWAP) projects. Additionally, Lukoil holds a 19.99% stake in the South Caucasus Pipeline project. "Lukoil" entered Azerbaijan in 1993 and joined the development project of "Azeri-Chirag-Gunashli" (ACG), one of the largest oil fields in the Caspian Sea, with a 10% share on September 20, 1994. It became one of the 11 oil companies from 7 countries that formed the Azerbaijan International Operating Company consortium. This international consortium included companies such as "AMOCO Caspian Sea Petroleum Ltd," "British Petroleum Exploration (Caspian Sea) Ltd," "Den Norske Stats Olyeselskap A.S.," "LUKoil Joint Stock Company," "McDermott Azerbaijan, Inc.," "Pennzoil Caspian Corporation," "Ramco Caspian Energy Ltd," "Turkiye Petrolleri A.O.," and "UNOCAL Caspian Ltd." The contract provided for the operation of the oil fields for 30 years. The current participants in the "Contract of the Century" are⁴¹ bp-34.14% (United Kingdom), Unocal-10.28% (USA), SOCAR-10% (Azerbaijan), Inpex-10% (Japan), Statoil-8.56% (Norway), ExxonMobil-8% (USA), TPAO-6.75% (Turkey), Devon-5.63% (USA), Itochu-3.92% (Japan), and Delta-Hess-2.72% (Saudi Arabia). In 2017, the parties signed a second agreement⁴² to extend this project until 2050.

³⁸ <https://lukoil.az/ru/About/GeneralInformation>

³⁹ <https://lukoil.az/ru/About/GeneralInformation>

⁴⁰ https://www.yelo.az/site/assets/files/12788/yelo_report_31_12_2023_aze_ri_-_issued_--compressed.pdf

⁴¹ https://www.bp.com/content/dam/bp/country-sites/en_az/azerbaijan/home/pdfs/e-books/Illham%20%C5%9Eaban_A%C3%87G.pdf

⁴² https://www.bp.com/content/dam/bp/country-sites/en_az/azerbaijan/home/pdfs/legalagreements/psas/ea-az-restated-acg-psa.pdf

"Lukoil" operated in the ACG project with a 10% share⁴³ until 2003. In 2003, Lukoil Overseas (BVI) Limited, a subsidiary of "Lukoil," sold all its shares in the Azeri-Chirag-Gunashli project to INPEX Corporation and INPEX Southwest Caspian Sea Limited, a subsidiary of Japan National Oil Corporation, for approximately \$1.354 billion⁴⁴.

According to bp⁴⁵, from the start of production at ACG in November 1997 until the end of the second quarter of 2024, 593 million tons (approximately 4.4 billion barrels) of oil were produced from ACG, with over 4.3 billion barrels of it being transported to world markets via the Baku-Tbilisi-Ceyhan pipeline. From the start of production until the end of the second quarter of 2024, approximately 57 billion cubic meters of associated gas from ACG were delivered to Azerbaijan. The capital expenditures of the ACG project amounted to \$45 billion by the end of the second quarter of 2024. Although the ACG contract was extended until the end of 2049 on September 14, 2017, a Russian company was not represented in the new composition.

Not all of "Lukoil's" projects in Azerbaijan's oil and gas industry have been successful. For instance, despite the signing of a contract on July 3, 1997, for the D-222 project, the agreement concerning the block considered part of the large Yalama structure, which spans both the Azerbaijani and Russian sectors and was expected to contain significant oil reserves, was terminated. Similarly, the contract signed on January 9, 2001, for the "Zigh" and "Hovsan" fields, which was approved by parliament, was canceled⁴⁶ before coming into legal force.

During the meeting between the President of Azerbaijan and the President of Russia's "LUKOIL" company, Vagit Alekperov, in Davos on January 21, 2020, the joint development of the "Nakhchivan" and "Goshadash" fields with "Lukoil" was discussed⁴⁷, and a decision was made on this matter. The following day, an agreement was signed, and exploration of the fields jointly with SOCAR began⁴⁸.

"Lukoil's" greatest success in Azerbaijan is its participation in the development⁴⁹ of the giant "Shah Deniz" gas field, which attracted significant international investment. The 40-year (+12 years) contract for the joint development of the field under the "Agreement on Exploration, Development, and Production Sharing for the Shah Deniz Prospective Area in the Azerbaijan Sector of the Caspian Sea" was signed in 1996. The development of the field began in 2001, and the first gas was obtained in 2006.

⁴³ https://www.bp.com/content/dam/bp/country-sites/en_az/azerbaijan/home/pdfs/legalagreements/psas/acg_psa.pdf

⁴⁴ <https://www.lukoil.com/PressCenter/Pressreleases/Pressrelease/lukoil-completes-sale-of-its-interest-in-the>

⁴⁵ https://www.bp.com/en_az/azerbaijan/home/who-we-are/operationsprojects/acg2/acg-30th-anniversary-in-facts.html

⁴⁶ https://www.bp.com/content/dam/bp/country-sites/en_az/azerbaijan/home/pdfs/e-books/Ilham%20%C5%9Eaban_A%C3%87G.pdf

⁴⁷ <https://vergiler.az/news/official/6745.html>

⁴⁸ <https://azn.marja.az/52853/lukoil-ve-socar-bu-gun-sazis-imzalayacaq>

⁴⁹ https://www.bp.com/en_az/azerbaijan/home/who-we-are/operationsprojects/shahdeniz.html

In the first phase of the "Shah Deniz" gas field, a consortium including "Lukoil" (10%), bp (28.83%), TPAO (19%), "Petronas" (15.5%)⁵⁰, SOCAR (10%), NICO (10%), and SGC (6.67%) began operations. The gas produced in the first phase of development was delivered to consumers via the Baku-Tbilisi-Erzurum pipeline.

The second phase of the "Shah Deniz" field's development began in 2013, with plans to direct the "blue fuel" produced at this stage towards Europe's energy supply. In 2015, "Lukoil" signed a \$1 billion loan agreement for 12 years with a banking consortium in Baku to finance the second phase of the field's development.

In October 2021, "Petronas" presented its proposal to sell its stake in the "Shah Deniz" gas-condensate field located in the Azerbaijan sector of the Caspian Sea to all project participants. In October 2021, "Lukoil" signed an agreement⁵¹ to acquire a 15.5% stake in the "Shah Deniz" project from Malaysia's "Petronas" for \$2.25 billion. In December 2021, "Lukoil" announced the signing of amendments to the agreement for the purchase of this stake from "Petronas," thereby completing the transaction⁵² to acquire the stake from "Petronas" in the "Shah Deniz" project. According to the amendment, "Lukoil's" acquired stake in "Shah Deniz" was reduced from 15.5% to 9.99%, and the transaction amount was proportionally reduced from \$2.25 billion to \$1.45 billion. According to the company's statement, under the new agreements, the value of the 9.99% stake that "Lukoil" acquired from "Petronas" was \$1.45 billion. As a result, "Lukoil's" direct participation in "Shah Deniz" increased to 19.99%.

It is worth noting that BP agreed to acquire a 1.16% stake in the "Shah Deniz" field from "Petronas" for \$168 million. This amount was agreed on the same commercial terms as the previously announced transaction by "Petronas" for "Shah Deniz." As a result, BP's total stake in "Shah Deniz" increased to 29.99%, and BP remained the operator of the field. In addition, SOCAR also acquired a 4.35% stake from "Petronas." This increased SOCAR's direct stake in "Shah Deniz" to 14.35%. Other participants in the "Shah Deniz" project include AzSD, "SGC Upstream," NICO, and TPAO.

Moreover, "Lukoil" participates with a 25% stake in the geological exploration project of the Shallow Water Absheron Peninsula (SWAP) located in the Azerbaijani sector. The current participation shares in the SWAP agreement are as follows⁵³: SOCAR's Joint Oil Company – 50%, BP – 25%, and "Lukoil" – 25%.

⁵⁰ <http://www.bloomberg.com/news/2014-10-13/statoil-sells-shah-deniz-stake-to-petronas-for2-25-billion.html>

⁵¹ <https://www.lukoil.com/PressCenter/Pressreleases/Pressrelease/lukoil-increases-its-share-in-the-shah-deniz>

⁵² <https://www.reuters.com/business/energy/russias-lukoil-spends-15-bln-raise-stake-azeri-gas-project-2022-02-18/>

⁵³ <https://apa.az/energy-and-industry/lukoil-xezerde-yeni-neft-yataginin-islenmesinde-istirak-edecek-663736>

Today, "Lukoil" is not only interested in oil and gas fields but also in alternative energy. "Lukoil," which has not invested in the energy transition sector, currently holds the second-largest stake after BP in "Shah Deniz," Azerbaijan's main gas field, which supplies gas to Europe, owning 20% of the shares. This field will remain Azerbaijan's primary export source for the coming decades. Additionally, "Lukoil" is a shareholder⁵⁴ in the South Caucasus Pipeline, the easternmost segment of the Southern Gas Corridor (SGC), and holds a 15.992% stake in the Azerbaijan Gas Supply Company, which is responsible for the transportation and sale of Azerbaijani gas to Europe via the SGC⁵⁵.

According to the Rystad Energy data analyzed by "Global Witness," Russia's "Lukoil" company intends to earn \$7 billion from supplying the European Union with gas from Azerbaijan between 2024 and 2033.

The results of Russian President Vladimir Putin's visit to Azerbaijan on August 18-19, 2024, show that Baku and Moscow have decided to expand their joint activities in developing new fields in the Caspian Sea. According to the Russian president, Russia's "Lukoil" company alone has invested up to \$4 billion in Azerbaijan's energy projects so far. He added that the Convention on the Legal Status of the Caspian Sea has created new opportunities for mutually beneficial cooperation, and that "Rosneft," in addition to "Lukoil," will begin joint activities with SOCAR in the near future to implement an oil and gas production project.

Before his visit to Baku, Russian Deputy Prime Minister Alexander Novak told the press that "we have a very broad spectrum of issues in the energy sector with Azerbaijan. This includes the development of joint ventures and the participation of Russian companies such as "Lukoil," "Tatneft," "Sibur," and "Novatek" in new projects with their Azerbaijani counterparts." For example, Russia's "Tatneft" oil company, together with the State Oil Company of Azerbaijan (SOCAR), will carry out the development of the "Bibi-Heybat" onshore field.

According to "Reuters," "Lukoil" has provided a \$1.5 billion loan to Azerbaijan's state oil company SOCAR. This will allow the STAR oil refinery in Turkey, which processes 200,000 barrels of oil per day, to once again process Russian oil. "Lukoil" is expected to begin supplying "Urals" oil to the STAR refinery starting in October, delivering approximately 100,000 barrels of oil per day, which is equivalent to half of the refinery's capacity.

Russia's private oil producer "Lukoil" will provide a \$1.5 billion loan to the SOCAR as part of a broader deal that will allow SOCAR to process Russian crude oil at Turkey's STAR refinery, which processes 200,000 barrels per day. According to APA, citing "Reuters," the agreement was announced on Thursday.

⁵⁴ <https://www.lukoil.com/Business/Upstream/Overseas>

⁵⁵ <https://www.sgc.az/en>

Conclusion

It should be noted that "Lukoil" is the largest company representing Russia's energy interests in Azerbaijan. It has actively participated in Azerbaijan's oil and gas sector for over 30 years in downstream, midstream, and upstream projects. After Russian President Putin's recent visit to Azerbaijan, new Russian companies will join the newly agreed energy projects between Moscow and Baku, and "Gazprom" and "Lukoil" will further expand their activities in Azerbaijan. Additionally, there are possibilities for transporting Russia's Urals oil through the Baku-Tbilisi-Ceyhan (BTC) pipeline across Azerbaijan and Georgia. The BTC pipeline, which ensures the safe and reliable export of crude oil to international markets, has a throughput capacity of 1.2 million barrels per day, or more than 50 million tons annually. In 2023, 75.9% of the total volume of oil transported through Azerbaijan's main oil pipelines was carried via the BTC. That year, the BTC pipeline transported 30.1916 million tons of oil, 82.6% or 24.9509 million tons of oil produced in Azerbaijan, and 17.4% or 5.2407 million tons was oil from Turkmenistan and Kazakhstan. As can be seen, the BTC pipeline's throughput capacity is utilized up to 60%. Considering that oil production in Azerbaijan is decreasing year by year, the BTC could become one of the alternative routes for transporting Russian oil to world markets in the future. This could be particularly significant if the embargo on Russian oil exports is lifted, which would [specific impact on the energy market]. Moreover, following disagreements over attracting investments in energy cooperation between Azerbaijan and Europe, it might be soon that new Russian companies are seen participating in Azerbaijan's existing and prospective oil and gas projects. As for the energy transition, the attraction of Russian-origin investments does not appear to be likely in the foreseeable future.