

THE EUROPEAN SOUTHERN ENERGY CORRIDOR | BACK TO THE EU GAS SUPPLIES RECONFIGURATION PROCESS



Big, strategic, geopolitical and classical energy issues, about oil and gas pipelines, their route, their financial profitability, their capacity, have disappeared from political radar screens. No-one could hardly remember the Nabucco, quite pharaonic, project, linking Turkey to Austria and set to supply Europe with gas for some several decades. Truly, Europeans had and still have substantial financial and monetary problems. Truly too, shale gas has to some extent put into question the traditional prevalence of hydrocarbons. Yet, pipes have recently come back, only for a while probably, on the front scene. A solution ensuring and securing on the short term gas needs of Europe seems to be in work.

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European gas supplies issues rapidly changed for the past six months. Mid-2011, five gas pipeline projects between the Caspian Sea and the EU, crossing Turkey and avoiding Russian territory were still considered in order to transport Azerbaijani gas to Europe¹. The Nabucco pipeline, the Interconnector Turkey-Greece-Italy (IGTI) and the Trans-Adriatic-Pipeline (TAP) are all known as the nominal components of the EU Southern Gas Corridor. They were competing each against other over Azerbaijan's gas from Shah Deniz-2. Two new projects did even join the pipeline race challenging in different degrees the pre-existing EU backed pipeline projects. The South East Europe Pipeline (SEEP) and Trans-Anadolu Dogalgaz Pipeline (TANAP) emerged in late 2011 only as possible new export options for Azerbaijan's gas.

Suspense is now over. The Azerbaijani-Turkish Trans-Anatolia gas pipeline project (TANAP), has been officially launched on June 26². This pipeline would run from the Georgia-Turkey border to the Turkey-EU border. Just two days after TANAP's official launching, the Shah Deniz gas producers' consortium in Azerbaijan selected Nabucco-West, eliminating SEEP, to be the route for Caspian gas into Central Europe³. Nabucco-West is the shortened version of the decade-old, unviable Nabucco pipeline project, which was to have run from Turkey's eastern border to Vienna. The shortened version eliminates the long stretch via Turkey. It would, instead, run from Bulgaria to Vienna, thereby drastically reducing Nabucco's construction costs.

The paper proposes to focus on the two challengers' specifications and rationales, TANAP and SEEP's, highlighting on one hand an obvious superiority for TANAP and some important doubts about SEEP's viability. Then, looking at the recent decision, it clarifies the new trends and key actors in European gas supplies.

| TANAP's obvious prevalence

TANAP project is a SOCAR initiative which was announced by SOCAR President on 17 November 2011 at the Third Black Sea Energy and Economic Forum held in Istanbul where he stated that a "new gas pipeline" stretching from Georgian – Turkish border to Turkey's Western border will be built in order to transport Azerbaijani gas to Europe⁴. This announcement came after the conclusion of the inter-governmental agreement between Azerbaijan and Turkey on October 25, 2011, known as Izmir gas agreements, on the sale and transportation of Azerbaijani gas from Shah Deniz-2. Already at the signing ceremony in Izmir, the Azerbaijani side made clear its preference for building "a new pipeline" for the transportation of Shah Deniz-2 gas production.

| Strong political support

Azerbaijan and Turkey reached an agreement on the creation of the consortium responsible for the construction and running the pipeline on December 26, 2011 when both countries signed a Memorandum of Understanding (MOU) on the construction of Trans-Anadolu pipeline. According to the project details, Turkish side will have a 20% stake interest while Azerbaijan's share will be 80%. Yet, third parties are allowed to join the consortium as minority shareholders. SOCAR President stated that "any company that has gas can join the venture to build a pipe from Turkey's eastern border to the west"⁵. Is it a hint to the Shah Deniz consortium shareholders among which "many have shown interest in this pipeline project" according to SOCAR president⁶. Nevertheless, Azerbaijan's state company SOCAR plans to keep the leadership role in the Trans-Anadolu consortium.

| Financial viability and scalability

The project costs are estimated at \$5 billion and it is supposed that the consortium partners will finance the pipeline's construction proportionally with their ownership interest stakes. This means that Azerbaijan and Turkey whose companies are involved in this project are responsible for financing the pipeline. There was no problem with reaching the financial support for this project since both countries are currently enjoying an economic boom (unlike EU member states that are facing serious financial and economic problems). Regarding the route itself, TANAP would use the Turkish state-owned Botas Company's pipelines which are to be upgraded from 16 to 23 and 31 bcm later. The pipeline scalability is important since it is likely that more gas will be available in Azerbaijan as the result of the exploration and development

¹ See Appendix 1 for a synthetic picture.

² *Anatolia News Agency*, 26-27 June 2012.

³ *Dow Jones*, 28 June 2012.

⁴ *News.Az*, 17 December, 2011.

⁵ *News.Az*, 21 December, 2011.

⁶ *Ibid.*

of Umid, Apsheron, Babek, ACG deep water, Shafak-Asiman gas fields (currently under development). It is expected that Azerbaijan's gas production will reach 50 bcm annually by 2025.

| SEEP's uncertainties

From the beginning, SEEP appears to be more an idea than a real matter. The project was proposed by BP Company, operator of the Shah Deniz gas condensate development project, few days before October 1, 2011, the deadline for the submission of competing pipeline proposals for the export of Shah Deniz-2 gas. But the route in January 2012 was not yet specified. The pipeline was said to run from Turkey to Austrian gas hub Baumgarten across Bulgaria, Romania and Hungary, some rumors also naming Croatia and Slovenia as possible transit countries. General details remained scarce. No official costs were long available. It was expected that they would be downsized as the project implied using already existing nationally-owned pipelines and inter-connectors in Central Europe, such as national grids in Bulgaria, Romania and Hungary. Regarding its capacity (10 bcm) and scalability (up to 20 bcm), there were only probabilities. Additional serious shortcomings have eventually casted a doubt on SEEP's reality.

| SEEP's lack of strategic scale

SEEP obviously lacked of Nabucco strategic vision to reduce EU quasi dependence on Russian's gas and to ensure safe and direct supplies for EU consumers coming from diversified sources. This was specifically underlined by one of the EU representatives to Azerbaijan who emphasized that the "SEEP was not a nominal component and has not been seen as a project able to contribute to the construction of the EU Southern Corridor because it does not involve the construction of a large capacity linear pipeline able to transport Caspian gas to Europe"⁷.

The pipeline small capacity is 3-folds less than Nabucco gas pipeline project. Despite the fact that SEEP is described as a "scalable" project, implying that its capacity can be increased later on, it is still questionable whether the national grids (pipeline sections and inter-connectors) with varying parameters and already busy with the transportation of the gas for domestic needs can be scaled-up. There were some doubts then on SEEP commitment to European energy security.

| A unique Azerbaijani source

SEEP only relies on the single gas Azerbaijani source from Shah Deniz-2. This situation is less convenient to the EU whose long term interests lay in the diversification of the gas routes and gas supplies as well. Unlike SEEP, Nabucco gas pipeline project was designed to transport not only Azeri gas but at a later stage, also non-Azeri such as Turkmen, and potentially Kazakh or Iraqi and Iranian gas.

| Missing the Turkmen gas

Accessing Turkmen gas via Azerbaijan is a high priority for the European Commission which was mandated by the EU's 27 member countries to negotiate with Turkmenistan and Azerbaijan on the construction of the Trans-Caspian pipeline. But, of course, the access of Turkmen gas to Europe will substantially depend on the chosen route from Azerbaijan, but also on its parameters, with scalable capacity as a decisive factor⁸.

| Key actors in the reconfiguration process

For a long time, BP and Azerbaijan's state owned company SOCAR—two key players in the Shah Deniz consortium—have expressed their concerns that Nabucco would make the shipment of their gas too expensive. The companies were afraid that two-thirds of the pipeline, which was to carry 31 bcm a year over a distance of 3,900 km, could remain empty, increasing thus the costs of shipping their gas. BP spokesman for Azerbaijan, T. Bayatly stated that "we want a pipeline that will make our Shah Deniz project commercially viable by reducing pipeline costs, whilst maintaining opportunity to scale-up capacity as new production becomes available"⁹.

⁷ Interview of an EU representative in Azerbaijan by Inessa Baban, Baku, 25 September, 2011.

⁸ Vladimir Socor, « South East Europe Pipeline : a downsized Nabucco proposed by BP », *Eurasia Daily Monitor*, Jamestown Foundation, November 2, 2011—Volume 8, Issue 202.

⁹ *The Wall Street Journal*, 27 September, 2011.

| BP's influence strategy in European Caspian projects

BP, as its operator, strongly influences the Shah Deniz consortium and plays an important role in the decision making on the gas export options from Shah Deniz-2. Moreover, the presence of BP Azerbaijan president, Rashid Javanshir at the signatory ceremony at Izmir on October 25, 2011 was interpreted as a promising step to the achievement of the SEEP project. At first sight, it indeed seemed that SEEP and TANAP, directly related to Shah Deniz-2 production, opposed the opening the EU Southern Corridor. SEEP however rapidly appeared more as a concept, which would be unlikely realized. A Senior Greek energy entrepreneur who served BP in senior positions recognized that the SEEP was more a "stratagem to put pressure on the three other consortia rather than stand on its own feet"¹⁰. It has worked quite well, as it forced Nabucco to reconsider and tighten its offer.

| Azerbaijani new strength in European pipelines projects

Unlike BP which has been seeking only to secure its investments in the development of Shah Deniz-2 field, Azerbaijan sought to achieve two more important goals: securing the Shah Deniz investments but also getting a stake in the consortium responsible with the construction and running of the pipeline to Europe. Azerbaijan's ambitions and goals are indeed to transport its own gas through its own pipeline to European markets and sell it directly to the European consumers¹¹, but Azerbaijan's state owned company SOCAR wasn't offered by any consortium involved in the development of the EU gas pipeline projects to participate in the construction of pipelines running to Europe. That was European fatal error since SOCAR has been playing a key-role in the decision making process on the choice of Azerbaijan's gas export routes¹². Therefore, it is no coincidence that the Tran-Anadolu pipeline was proposed by SOCAR. If constructed, the Trans-Anadolu Pipeline would allow to Azerbaijan, for the first time, to transport its own gas using an Azerbaijani-owned pipeline and sell it directly to European consumers. This is extremely important politically and economically to Azerbaijan who has been seeking to sell its gas directly to Europe bypassing Turkey as an intermediate for a long time.

| Reconfiguring Nabucco and the European Southern Corridor

TANAP has significantly impacted on Nabucco, forcing the framing of a revised and updated Nabucco version. The Trans-Anadolu pipeline has revitalized the EU Southern Gas Corridor with the downsized Nabucco pipeline stretching from Western Turkey to Austria. This option shortens Nabucco and thus lowers its investment costs. Interestingly, as early as January 2012, that idea had been evoked by a non-official SOCAR insider, Sabit Bagirov, its former president saying: *"With the implementation of the Trans Anadolu Dogalgaz Pipeline, the necessity to construct the Turkish section of Nabucco will disappear, and the builder will only need the gas pipeline section from Turkey through Bulgaria to the distribution point in Baumgarten in Austria. In other words, with the implementation of the Trans Anadolu Dogalgaz Pipeline, only the section of the Nabucco route falling on European territory will need to be built"*¹³. He did not even mention the SEEP option.

Prospectively, taking into account as well BP's concerns on export routes, it would be not surprising that the British company would enter into Nabucco consortium, eliminating then the last concurrent of Nabucco, the Trans-Adriatic Pipeline, proposing to bring Azerbaijani gas from TANAP to Italy. An official decision on the final route after TANAP, between Nabucco-West and TAP is to expect mid 2013. The latter has only marginal chances.

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¹⁰ *European Energy Policy Observatory*, October 10, 2011.

¹¹ Interview by Inessa Baban, Baku, July 2011.

¹² *Ibid.*

¹³ SOCAR first president Sabit Bagirov, *The Moscow Times*, 12 January 2012.

Appendix 1 | Table of projects specifications

Projects	Route & Length	Project partners & Operator	Capacity (bcm/year)	Estimated cost	Build-up start time
Nabucco	3 863 km Turkey, Bulgaria, Romania, Hungary, Austria	Botas (Turkey), Bulgarian Energy Holding (Bulgaria), Transgaz (Romania), MOL/FGZS (Hungary), OMV (Austria), RWE (Germany) Each shareholder holds an equal of 16.67%. Operator: Nabucco Gas Pipeline International GmbH.	31bcm	<i>Initial</i> €7.9bn <i>New</i> €14bn/€15bn	2013
Interconnector Turkey Greece Italy(ITGI)	807 km Turkey, Greece, Italy	DEPA (Greece, 50%), Edison (Italy, 50%) Operator: IGI Poseidon S.A.	10bcm	€2.0bn/€2.5bn	2012
Trans-Adriatic Pipeline (TAP)	800 km Greece, Albania, Italy	EGL (Swiss, 42.5%), Statoil (Norway, 42.5%), E.ON Ruhras (Germany, 15%) Operator: Trans Adriatic Pipeline	10bcm	€1.5bn/€2.0bn	2012
Trans-Anadolu Pipeline (TANAP)	1800 km Turkey (<i>Georgian to Western borders</i>)	SOCAR (Azerbaijan, 80%), Botas (Turkey, 10%), TPAO (Turkey, 10%) Operator: SOCAR	16bcm (2018) 23 bcm (2023) 31 bcm (2026)	US\$5-7bn	2014
South East Europe Pipeline (SEEP)	3800 km Turkey, Bulgaria, Romania, Hungary, Austria, Croatia (?)	BP (nc) SOCAR (nc) , Statoil (nc) No confirmation but high probability	10 bcm	<i>No information available</i>	2013

Source | Emerging Actors Consulting