

The Conundrum of the Southern Gas Corridor: What are the Risks for Europe and Azerbaijan? The viewpoint of an insider

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Executive summary

For more than ten years harsh negotiations among different oil majors and pipeline consortia have been taking place about the Southern Gas Corridor, all of them seeking to transit 10 bcm/year of natural gas that will be produced from the Shah Deniz giant gas field of Azerbaijan to the European Union. As of today, no Final Investment Decision (FID) has been reached neither for the preferred pipeline route to Europe, nor for the production of the second phase of Shah Deniz.

Yet a decision has to be made. Europe will remain a major gas importer as clearly shown by the International Energy Agency's scenarios for 2035. Even if shale gas may be a game-changer as far as Chinese needs for gas imports are concerned, many uncertainties remain regarding the risk of the EU competing with China in the global market for natural gas imports. Consequently the EU needs to secure its gas supplies. What is at stake is nothing but its competitiveness in the world economy. In the words of EU Commissioner for Energy, Günther Oettinger, "*globally, demand growth poses a threat to security of supply and, with its impact on prices, our economic competitiveness.*"

In this context, the EU has to quickly make a decision regarding the Southern Gas Corridor unless the three major risks for the realization of the Southern Gas Corridor become too heavy. First, the delay of the FID of the Shah Deniz Consortium in Azerbaijan causes an acceleration of the economic and

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geopolitical costs which threaten the energy security of Europe¹. Associated with that risk is the potential internal disagreement between SOCAR, the State Oil Company of Azerbaijan, and BP, the two most important shareholders of the Shah Deniz consortium. Second, the development of South Stream poses a risk for the delivery of Azerbaijani gas to Europe via the Southern Gas Corridor. Gazprom is indeed already ahead of the geopolitical rivalry, since the construction of South Stream was officially inaugurated, last December 2012, by Russian President Vladimir Putin. Gazprom is aiming to construct first the South Stream, and sign new gas supply contracts with the South Eastern (S.E.) European countries, in order to weaken both commercially and geopolitically the pipelines under design, namely Nabucco West, Trans Adriatic Pipeline (TAP) and Trans Anatolian Pipeline (TANAP²). Third, the worsening of the Eurozone crisis, with the potential of further political and economic instability, is a major risk for the opening of the Southern Corridor, as it makes the construction of the gas infrastructure more expensive and also weakens the political will. In particular, in the context of the Greek debt crisis and its effect on the Eurozone, an additional risk is linked to the privatization of the Greek gas industry DEPA and DESFA. Gazprom is the front runner in winning the bid for the Greek privatization, and if the Russian gas monopoly was to acquire the gas industry of Greece, which has a crucial geostrategic position being one of the only two entry points for the Azerbaijani gas to EU via an onshore pipeline, then the Southern Gas Corridor³ would meet an additional strategic (geo)political obstacle.

The future challenge for the Southern gas Corridor lies in its efficient opening with the Shah Deniz gas supplies and with the completion of a credible gas infrastructure that will deliver future gas supplies to the EU from the Caspian region. This requires strong leadership and unwavering will from the governments, the oil majors and the gas pipeline consortia.

We are at the most critical stage of this project. Which pipeline will deliver the Shah Deniz gas to the European Union (EU): Nabucco West or Trans Adriatic Pipeline (TAP)? What is the role of Trans Anatolian Pipeline (TANAP)? A decision made today will enable the EU to build its own margins of manoeuvre and secure its long-term security of gas supply.

¹ The energy security of Europe is defined here in terms of gas supply security, which is the diversification of routes and resources. The security of gas supply is one of the most important factors for the overall energy security of Europe.

² TANAP is intended to be a large scale pipeline 56 bcm gas pipeline with a maximum 60 bcm capacity, according to Gulmira Rzayeva in her article: "A Complicated Corridor: Gas to Europe-it's not just economics" Caucasus International, Vol. 2, No: 2, Summer 2012, "The Caspian Energy Dance: Towards a New Age of Partnership?", p.149. This is the reason why I claim that TANAP is a competitive pipeline to South Stream. Furthermore Russia is seeking to purchase large quantities of natural gas from the Caspian region (Azerbaijan, Turkmenistan, Kazakhstan) and relay them to the European market. This is at the cornerstone of Russian energy policy.

³ Southern Corridor is defined in this paper in accordance to the declaration of Prague summit that was signed on 8 May 2009 which is focusing on Caspian oil and gas supplies and consider it as "the modern Silk Road" that includes the "trans-Caspian energy transportation projects" and "envisage a mechanism for aggregating sufficient volumes to be transported through the Southern Corridor and take note of the feasibility study of the Caspian Development Corporation initiative" and is seeking to "establish direct connections between both sides of the Caspian Sea as one of the main important elements of the effective energy cooperation and favour the interconnection of the Southern Corridor with the EU through strategic infrastructure projects." Prague Summit, Southern Corridor, May 8, 2009 www.eu2009.cz/assets/news-and-documents/press-releases/the-declaration---prague-summit--southern-corridor--may-8--2009.pdf.

Introduction

For the last decade the EU has focused its gas supply policy in the natural gas-rich-region of Eurasia, especially in the Caspian Sea. The discoveries of vast gas reserves in Azerbaijan and Turkmenistan have led the European energy policy to seek the opening of a “Southern Corridor”, as opposed to the Northern Corridor bringing gas from Russia, avoiding traditional transit countries. Since the Caspian states are landlocked, natural gas is not worth much at the well-head and needs to be moved and delivered to the points of distribution. In order to transit the gas from the Caspian to the EU market the construction of gas pipelines that cross several countries is therefore needed.

The Southern gas Corridor is a classic case study of who owns and who controls the pipelines. SOCAR, BP, Statoil, OMV, Botas, the gas pipeline consortia Nabucco, and TAP have been engaged in a harsh competition for the ownership and control of the pipelines. While the investment rate of return is nearly as high as in the upstream, the primary incentive for the oil majors to own and operate pipelines is to secure the trading of their gas production.

Most efforts in the past decade have been practically focused on the Shah Deniz giant gas field of Azerbaijan. The Shah Deniz gas is hugely important, not only because of its size, but also because the opening of the Southern Corridor is an open door on the whole Caspian sea reserves. As EU Energy Commissioner Günther Oettinger recently stated in Frankfurt, *“the 10 bcm annual gas that EU will import from Shah Deniz II is small to the overall needs of the EU. On its own this quantity could not justify all the efforts put forward from the EU, but with the Shah Deniz gas the Southern Corridor will open and future gas supplies from the Caspian can be imported to the European market.”*⁴

The FID of the Shah Deniz consortium is the fundamental decision that will shape the future structure of the Southern Corridor. Nabucco West and TAP, which are the only two pipeline options left, are currently competing. The rationale behind each project is different: while Nabucco West has a larger strategic impact, TAP has undoubtedly a larger commercial advantage. The first one delivers the Shah Deniz gas to Baumgarten, Austria and the latter to Italy. Both consortia have gone a long way over the past decade to change and adjust their shareholders and objectives to the new commercial and geopolitical realities matching those emerging in the geopolitical arena of Eurasia. Most of those “adjustments” took place during the past fifteen months after Turkey and Azerbaijan announced their decision to a transit tariff for the Azeri gas and, simultaneously, their intension to construct the Trans Anatolian Pipeline (TANAP): a brand new pipeline that will cross Turkey up to the EU border with Bulgaria and Greece with an initial throughput capacity of 6 bcm in a 30 bcm capacity pipeline and with *“the possibility of adding a second parallel line to*

⁴ Günther Oettinger, Keynote Speech delivered at the First Annual Frankfurt Gas Forum, Frankfurt, Germany, 29 November 2012.

double throughput to 60 bcm/yr”⁵. In this open competition, one certainty arouses: TANAP is the winner pipeline for Turkey and Azerbaijan as it will be linked with either TAP or Nabucco West when the Shah Deniz consortium finally decides. Azerbaijan and Turkey are key countries for the Southern Corridor, because the first one produces the natural gas and the second one is the ‘Golden Gate’ to the European Union. This paper aims at showing that the Trans-Anatolian Pipeline (TANAP) is a game changer in the Southern Corridor and how it sheds a new light on the classic questions around the Southern gas corridor: what are the risks the Southern Gas Corridor is facing due to the EU delaying for making a decision? What is at risk for both Europe and Azerbaijan? Will Nabucco West or the Trans-Adriatic Pipeline (TAP) transit the Shah Deniz gas to Europe? What is at stake for SOCAR. To answer the aforementioned questions, this paper will use an analytical framework based on the commercial competition of the gas pipeline consortia as well as on the geopolitical rivalry among the countries in the Caspian region - Europe, and Russia. Special emphasis will be given to the commercial players themselves, whether the oil and gas majors such as BP, Statoil, and the SOCAR or as the gas pipeline consortia - Nabucco West, TAP, and TANAP

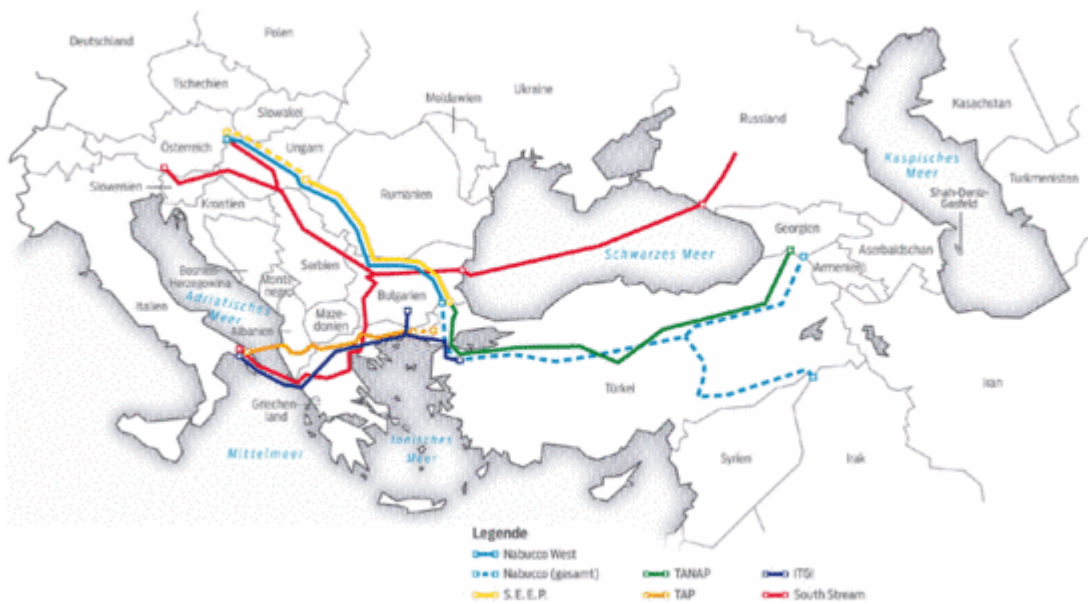


Figure 1: Map of Caspian Region, Black Sea, Russia, Turkey, S. E. Europe and the Conundrum of the Southern Gas Corridor. (Source Wingas GmbH 2012) For more than a decade six gas pipeline consortia have been engaged in a fierce geopolitical and commercial competition to transit the gas from the Azerbaijani giant field Shah Deniz.

⁵ Gulmira Rzayeva quoted in “Tanap: Pipeline offers security with demand for energy growing” Financial Times, November 21, 2012.

One Corridor, two players left... and a winner already known.

Nabucco West: The Front Runner

From the beginning of the negotiations for Southern Corridor until today, Nabucco has been ahead of the game. With maximum political support from Brussels, Washington, and Berlin, Nabucco has been positioned as the strategic pipeline for the European energy security. It is the most ambitious gas infrastructure project as it aims to deliver the Azeri gas to the heart of Europe, in Baumgarten, Austria. A large size 31 bcm/year gas pipeline, as it was initially designed, had the maximum strategic impact. Nabucco was ambitiously designed to be build crossing Turkey up to Austria (with 3900 kilometres in length!). However, after Turkey and Azerbaijan announced their decision to construct TANAP, the Nabucco consortium had to come up with a smaller version: the Nabucco West, a 23bcm pipeline that will be connected with TANAP at the Turkish - Bulgarian border⁶. Nabucco West is designed to be built inside the EU crossing Bulgaria, Rumania, Hungary and Austria⁷.



Figure 2: Map of Turkey, Bulgaria, Rumania, Hungary, Austria & Nabucco and Nabucco West (Source: Wingas GmbH, 2012) Today Nabucco West , the smaller version, will be linked with the TANAP pipeline in the Turkish Bulgarian border. The initial Nabucco proposal that was supposed to be constructed in Turkey has been abandoned.

Whatever its strategic positioning, Nabucco has always been challenged both for economic and political reasons. The commerciality of Nabucco has been doubted by its competitors and prominent gas experts. According to them⁸ the available gas supplies are not enough for the construction of such a huge pipeline. The Shah Deniz gas is not adequate to fill up Nabucco, in order for the FID to be reached, and

⁶ TANAP will accelerate implementation of the Nabucco Project, Turkish Energy Minister Taner Yildiz said in an interview, on 26 December 2012, with the Hazar World magazine, Trend news agency reported. He said that Turkey continues to support the Nabucco project which, together with the TANAP project, aims at diversifying gas supplies to Europe and opening up new markets for Caspian gas. www.azernews.az/oil_and_gas/47970.html.

⁷ Nabucco West is approximately 1.300 km in length that will transport up to 23 bcm/year. The current shareholders are: OMV, FGSZ, Transgaz, Bulgargaz Holding, and RWE.

⁸ John Roberts, "The Nabucco natural gas pipeline is dead. Long live Nabucco!", Platts, July 5, blogs.platts.com/2010/07/05/nabucco_is_dead/.

be commercially viable. Moreover, geopolitically Russia perceives Nabucco as a threat, because its aim is to supply with gas the South Eastern European countries where Gazprom covers the majority of gas demand - especially Bulgaria where Gazprom is, today, the only supplier of natural gas.

In addition to these obstacles from its competitors, Nabucco had to confront a new proposed pipeline, the South East European Pipeline (SEEP) which was announced in September 2011 by BP. SEEP was competing directly with Nabucco on the same route and was presenting as commercially viable. Although SEEP was just a paper project with no agreements whatsoever⁹, it was considered seriously, as being proposed by BP, the British oil major being by far the most powerful and influential company of the Southern Corridor.



Figure 3: Map of Bulgaria, Rumania, Hungary, Austria, and South East European Pipeline-SEEP (Source: Wingas GmbH, 2012) A BP proposed pipeline aiming to utilize existing national gas grids. In the summer of 2012 the Shah Deniz chose Nabucco West over SEEP for that route. Today this is the pipeline route of Nabucco West.

The Nabucco consortium showed flexibility and extraordinary negotiation skills with these two challengers, TANAP and SEEP, which threatened its very existence. By the end of Spring 2012, a smaller version, the Nabucco West, was thus proposed¹⁰, which proved a winner for the northern route of the Southern Corridor. SEEP was officially phased out from the Shah Deniz consortium, opening the way to the final round of competition. Looking back, it appears that SEEP was probably the best development that could happen for to Nabucco, as it gave the incentive to this pipeline consortium to downsize its initial grand design. The initial version of Nabucco was indeed impossible to realize, especially as it considered, at the initial stages, gas supplies from Iran or from Iraq, that will not be available any time soon. Similarly, a Trans-Caspian pipeline that would feed Nabucco with Turkmen gas is not feasible in the foreseeable future, due to geopolitical challenges from Iran and Russia. Consequently, Nabucco, as it was initially designed, had lost

⁹ There was neither any Memorandum of Understanding neither any Intergovernmental Agreement.
¹⁰ “Nabucco West Makes its Official Entry in Southern Gas Corridor Contest” Natural Gas Europe, May 17 2012, www.naturalgaseurope.com/nabucco-west-southern-gas-corridor.

the race before it even started.

Almost immediately upon receiving the shorter version of Nabucco West, BP and the Shah Deniz consortium placed “*SEEP out of the running*”¹¹. While BP did officially back the Nabucco West. Furthermore, on 19 January 2013, Nabucco West shareholders “granted to SOCAR, BP, Statoil, and TOTAL options to take up to 50% equity in the project and to participate Nabucco shareholder structure, following a positive selection of the Nabucco West pipeline by Shah Deniz consortium”¹². BP, with the proposal of SEEP, exercised pressure on Nabucco, leading the consortium to compromise in a smaller version, which is commercially more viable and will cooperate with TANAP, in line with BP’s commitment to cooperate with Turkey and Azerbaijan on their favourite pipeline route. There could not be any better outcome for Nabucco, as the new version of Nabucco West is both geopolitically strong and commercially very competitive.

Trans Adriatic Pipeline (TAP): The Surprise of the Outsider

When TAP was launched in 2003, it was perceived as an outsider. Its final route was determined only in March 2007 after a pre-Front End Engineering Design (pre-FEED). Especially, in comparison with the ITG, the Interconnector Turkey Greece – ITG, the pipeline that, in 2007, Greek Prime Minister Karamanlis, along with his counterpart Turkish Prime Minister Erdogan, inaugurated, the TAP management could hardly have any meetings with a senior official from the Greek, Italian or Turkish governments.

The dynamic of TAP changed on 13 February 2008 when Statoil joined the consortium and agreed, along with EGL (now Axpo), to develop the TAP pipeline. By 2008, ITGI had an intergovernmental agreement with Greece and Italy for the construction of the onshore and offshore pipeline, where the offshore part was a joint venture between Greek DEPA and Italian Edison, and the Greek DESFA would construct the onshore part on the Greek territory. BOTAS on Turkey would upgrade the Turkish grid in order to transit the 10bcm/yr of the Shah Deniz gas to Europe. TAP was perceived as a project with less maturity vis-à-vis ITGI and the argument put forward from Greek DEPA and Italian Edison was that environmental licenses and geopolitical agreements were not at place. In the domestic Greek and Italian media, the perception was that TAP had no chance whatsoever to transit the gas of the Shah Deniz. This perception was prevailing even among experienced energy policy officials at the Greek and Italian Energy and Foreign Affairs Ministries. Of course many policy makers who understood the international commercial and geopolitical realities of the Caspian gas resources knew that STATOIL was, along with BP, the two oil majors that had the majority of shares (51%) of the upstream Shah Deniz consortium and they had doubts on the financial credibility of the ITGI joint venture. After 2010 TAP intensified its pipeline development efforts, when the

¹¹ “*SEEP Out of the Running for Shah Deniz*” Natural Gas Europe, 28 June 2012, www.naturalgaseurope.com/seep-tap-final-shah-deniz-contest

¹² “*NABUCCO Shareholders sign Cooperation and Equity Option Agreements with Shah Deniz Partners*” Official Nabucco Gas Pipeline International GmbH Press Release, 19 January 2013.

German Eon-Ruhrgas became a shareholder in the TAP consortium.

It was expected that Eon-Ruhrgas would cooperate with Statoil in order to strengthen the political support from Brussels and Berlin. According to the official German energy policy, *“the construction of a Southern Corridor could provide a key new source of gas supply. The aim of the Southern Corridor is to transport gas from the Caspian region, Iraq, and possibly also the broader Middle East to Europe and Germany. This project could be implemented with the planned Nabucco pipeline, for example which is to have an annual capacity of 30 bcm when completed and is to transport gas from the Caspian region or Iran/Iraq to Baumgarten in Austria via Turkey, Bulgaria, Romania, and Hungary”*¹³. Officially, at a political level, Nabucco is still receiving substantial political support from Berlin. The participation of Eon-Ruhrgas in the TAP consortium had two objectives: first to strengthen politically the relations of this pipeline consortium with Berlin and Brussels and secondly to strengthen the economic credibility and commerciality of TAP. One of the strongest economic arguments of TAP is that it will rely solely on private funds to build its pipeline. TAP indeed is requesting only political support from Brussels, not economic help...

TAP has gone a long way since the Shah Deniz consortium announced in February 2012 that TAP, and not ITGI, was the preferred route for the delivery of gas to Italy via Greece. Undoubtedly, this was a clear victory for TAP. This came as a surprise to Athens and Rome. However, it was clear to many gas negotiators and experts that ITGI consortium companies had no chance to sign the gas supply contract of Shah Deniz, after TAP had systematically taken advantage of the weaknesses of its major pipeline competitor. One of the most important weaknesses of the ITGI consortium was the Italian and Greek debt crisis and its effect on the Eurozone and, consequently, to the credibility of DEPA, DESFA and Edison.



Figure 4: Map of Greece, Albania, Italy and Trans Adriatic Pipeline-TAP (Source: Wingas GmbH, 2012)

¹³ *“Die Energie Wende in Deutschland: Mit sicherer, bezahlbarer und umweltschonender Energie ins Jahr 2050”* Bundesministerium für Wirtschaft und Technologie, Berlin, September 2012, p. 51, www.bmwi.de/BMWi/PDF/deutschland,property=pdf,bereich=bmwi2012,sprache=de,rwb=true.pdf.

Today TAP, having prevailed over its immediate competitor, the ITGI, needs to win the battle for the transit of the Azerbaijani gas against Nabucco West. The most important argument put forward from TAP was the advantage of commerciality. From its inception until today, TAP argues that it is the most viable pipeline in terms of commerciality, with the lowest cost and the fastest most efficient route to EU for the Shah Deniz gas. Nevertheless, winning against Nabucco West will be a much more difficult challenge for the consortium which is supported by Statoil. Nabucco West, as it has evolved today with its smaller version, is much less expensive than the original Nabucco, is more down to earth in terms of its transit capacity, not mentioning that it transits the Shah Deniz gas to the very heart of the EU, in Baumgarten, Austria. Furthermore Nabucco West, even with its current smaller scale, has a larger strategic impact for the energy security of EU. It reaches the vulnerable Eastern European countries of Bulgaria, Rumania, and Hungary that are overly dependent on Gazprom.

TAP is nevertheless getting stronger politically. In spite of the many challenges within the Greek and Italian governments that TAP had to overcome - especially in Greece, where the ITGI consortium companies still have an influence among policy makers, on 13 February 2013, TAP signed in Athens an Intergovernmental Agreement (IGA) with Greece, Italy and Albania¹⁴. The IGA gives the political support that is essential for TAP in order to negotiate effectively with the Shah Deniz consortium. Beyond the IGA, TAP will need some further political support from Greece and Italy, to the government of Azerbaijan. A support which is far from being granted considering the huge challenges – economic, political, social – those governments have to face in the current context of crisis in the eurozone. Furthermore, in the case of Greece, there is no adequate political support, as Edison still tries to influence the domestic Greek public policy by having a strong presence with investments in power plants and a joint venture with Hellenic Petroleum. This lack of support from Greece may appear as a paradox as TAP has a geopolitical important for Greece. As a matter of fact, this project is far more important to Greece than to Italy. While TAP would be the first large scale international pipeline that would transit the Azerbaijani gas, open the Southern Corridor and strengthen both Greece's geopolitical role as well as its economic development, Italy already has several large scale pipelines, as for example Green Stream for the transit of Libyan gas.

Lack of political support for the TAP consortium all the more challenges its chances for winning that, with the gas supply agreements, Azerbaijan aims also at strengthening its political relationships in Europe. Geopolitics is indeed of primary importance for Baku. Bilateral meetings with the respective Ministers of the transit countries are crucial for the final decision of the preferred gas transit route.

¹⁴ Anthony Livianos, "Greece is Risking to be Out of the new Pipeline Projects" (Κίνδυνος Εξόδου της Ελλάδας απο τα Σχέδια των Νέων Αγωγών) Energy World January 2013, No. 42, Athens, pp. 16-20

TAP therefore needs to work more on the political sphere and to build further on its new success the intergovernmental agreement, especially during this year which is the most critical for the final investment decision of the Shah Deniz consortium. 2013 will be a year of decisions for the Shah Deniz consortium. The Greek and Italian leaders cannot be absent from Baku, or they will lose TAP. Similarly the two countries need to engage much more dynamically in negotiations and agreements with the EU in Brussels. The debt crisis cannot be an excuse. It could be argued quite the contrary: because of the debt crisis, Greece and Italy should do whatever it takes to support TAP. Up to now, one must acknowledge that TAP gained the victory in Baku and defeated ITGI by itself, and itself only...

Trans Anatolian Pipeline (TANAP): Winner Takers it All

TANAP is a “*strategic game changer*”¹⁵ for the gas pipeline competition of the Southern Corridor. The pending gas transit agreement between Turkey and Azerbaijan was a thorny issue that was delaying a substantial progress of the Southern Corridor. After years of negotiation, the two countries finally agreed on the legal and commercial terms for gas transit from Azerbaijan to Europe via Turkey and separately for Azerbaijani gas supplies to Turkey.¹⁶

Moreover, they agreed on a new infrastructure, which changed the gas pipeline game: the construction of a brand new pipeline in the Turkish territory, the TANAP. On 26 December 2011 Turkey and Azerbaijan signed a Memorandum of Understanding (MOU) for the construction and operation of TANAP, followed by the signature, on 26 June 2012, of an Intergovernmental Agreement (IGA) by Prime Minister Erdogan of Turkey and President Ilham Aliyev of Azerbaijan. The construction of the TANAP is expected to be completed in 2018.

¹⁵ Gulmira Rzayeva, “A Complicated Corridor: Gas to Europe –it’s not just economics” Caucasus International, Vol. 2, No: 2, “The Caspian Energy Dance: Towards a New Age of Partnership?” Istanbul, Summer 2012, p.150.

¹⁶ Eurasia Daily Monitor, “Azerbaijan and Its Gas Consortium Partners sign Agreements with Turkey” The Jamestown Foundation, Nov. 1, 2011, www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D038603.

The official website of the Turkish Ministry of Foreign Affairs states: “Through these agreements Azerbaijan has gained the right to transit 10bcm of gas through Turkey’s national gas network and the opportunity to start negotiations on the possible construction of a new standalone pipeline through Turkey. A Memorandum of Understanding was signed between Turkey and Azerbaijan concerning a standalone pipeline in Ankara on 24 December 2011, namely the Trans-Anatolian Pipeline (TANAP) The Intergovernmental Agreement and the Host Government Agreement regarding development of the standalone pipeline (Trans Anatolian Pipeline, TANAP) project, was signed by Turkey and Azerbaijan on 26 June 2012 in Istanbul.” Republic of Turkey, Ministry of Foreign Affairs, “Turkey’s Energy Strategy” www.mfa.gov.tr/turkeys-energy-strategy.en.mfa.



Figure 5: Map of Turkey and TANAP (Source: Wingas GmbH, 2012)

TANAP had a direct impact on what was still at that time the initial Nabucco project. It rendered the Turkish section of Nabucco obsolete. Nabucco, in order to stay in the race, was forced to adjust its initial plan and to shorten its route inside the EU territory only. In the current project, the Nabucco West version, a new shorter pipeline is designed to be connected with TANAP at the Turkish-Bulgarian border, and Nabucco West has stated its commitment to be connected¹⁷ with TANAP in order to transit the Shah Deniz gas to Baumgarten, Austria.

Nevertheless, the TANAP shareholders have not taken sides either with Nabucco West or TAP. Consequently, TANAP is designed to reach the Turkish-Greek border as well. Therefore, would the Shah Deniz consortium eventually choose TAP, TAP would be anyway linked to TANAP. Turkey does not want to intervene in the final selection gas pipeline process of the Shah Deniz consortium. By designing the TANAP to reach both the Turkish-Greek and the Turkish-Bulgarian border the maximum flexibility is given to the Shah Deniz consortium to select the best pipeline according to the consortium's criteria.

A clear winner takes it all: TANAP demonstrated masterfully the commercial and geopolitical skills of Turkey and Azerbaijan. Turkey and Azerbaijan are bound together in a strategic partnership that illustrates the trust between the two countries. On the TANAP website the President of Azerbaijan Ilham Aliyev is quoted: *“Azerbaijan has been an independent country for the last twenty years. During this period Turkish-Azerbaijan relations have always been at high level. These relations are getting stronger and deeper. Bonding and fellowship have stood all the foundation of these relations. The great leader Atatürk said ‘Azerbaijan’s grief is our grief, their happiness is our happiness.’ I am very happy to be experiencing these*

¹⁷ Official website of Nabucco pipeline states: *“the Nabucco West pipeline would bring Caspian gas from the Turkish-Bulgarian border to the European Gas turntable in Austria and beyond. Nabucco West will run from the Turkish-Bulgarian border to the vicinity of the gas hub at Baumgarten near Vienna, Austria. The pipeline will pass through Bulgaria, Romania, Hungary, before it reaches Austria. The route distances are as follows: Bulgaria: 412 km, Romania: 469 km, Hungary: 384 km, Austria: 47 km. The total length of the pipeline will be 1300 km.”* www.nabucco-pipeline.com/portal/page/portal/en/press/Nabucco%20West%20Scenario.

joyful days."¹⁸. No doubt that President Aliyev was happy since SOCAR owns 80% of the shares of TANAP, the rest being owned by Turkish energy companies TPAO (10%) and Botas (10%). SOCAR's financial resources guarantee the financing of the pipeline which is estimated at \$7 billion. And SOCAR would be the operator of TANAP...

Why did Turkey agree to such a deal? A reason certainly lies in the deep trust between Ankara and Baku - Azerbaijan is the country that Turkey trusts more than any other one in the region. The country is aiming to strengthen its strategic relationship with Azerbaijan and to lay the foundation of its future energy policy in Eurasia. It can build up its position as the golden gate of Eurasian natural gas to EU through a solid partnership with Azerbaijan. Turkey has kept all the options opened by being a shareholder of Nabucco, by having a binding IGA, completing in 2007 the construction, jointly with Greece, of the Turkish Greece Interconnector and supporting the ITGI, continuously cooperating with TAP. On the other hand Azerbaijan, in the long run, is aiming to become a transit country of gas from the other side of the Caspian Sea, in order to have primarily geopolitical gains and secondarily economic. Turkmen gas can be transited to EU via Azerbaijan, only if Azerbaijan takes the right decisions now, meaning to own and control the vital gas transportation routes. Azerbaijan understood, a long time ago, that transportation is pivotal in the Caspian.

Turkey's decision to grant 80% of the TANAP shares to SOCAR might teach a lesson of successful negotiation skills to Russia, on how to own and operate gas pipelines. Gazprom religiously believes in full ownership and control of the majority of shares in gas pipelines transiting Russian gas, in every single country these pipelines are crossing. Several times Russia found itself in a stalemate with the pipelines' development.¹⁹ And quite often, Russia has sought to exercise geopolitical influence and to maximize its political power by leveraging its gas pipelines.²⁰ Turkey agreed to have SOCAR as majority shareholder and operator of TANAP in a pipeline that crosses Turkey. The advantages are obvious since Turkey will earn from transit fees, taxes, job creation, reduced financial costs, higher geopolitical influence and stronger security of gas supply. The future of gas pipelines is one of co-operation and joint ownership. The EU energy policy aims to create a flexible unified European energy market where the gas pipelines will foster free market competition and will provide both security of supply and security of demand. The European Union has the political will and is determined to achieve this goal.

¹⁸ www.tanap.com/en/the-energy-of-the-future-is-ready.aspx.

¹⁹ A recent example is the South Stream pipeline branch, which was designed to transit gas via Greece to Italy, has been cancelled this year unilaterally from Gazprom. Russia has not been very flexible to consider other shareholders and to give up its majority stake. As a matter of fact even considering other options from shareholders most of the time is out of the question for Gazprom.

²⁰ An excellent analysis on this issue is written by Marshall I. Goldman, *Petrostate: Putin, Power, and the New Russia*, Oxford University Press, 2010, pp. 94-209.

The three Major Risks for the Southern Gas Corridor

First Risk: “Kicking the Can Down the Road” or how a further delay of FID of Shah Deniz due to Disagreements between BP and SOCAR would endanger the project

The investment in the Southern Corridor is too big and too complex to afford any further delay. The procrastination of the FID accelerates the cost, gives extra time to the geopolitical competitors, such as Russia, and encourages internal consortium disagreements. During the last two years the price of commodities has risen, thus creating an upward spiral to the cost of construction of the gas pipelines.

The most threatening risk is the potential disagreement between BP and SOCAR, which are the most significant shareholders in the Shah Deniz consortium. The most recent open disagreement, which was not directly related to the Shah Deniz, occurred in October 2012. The issue of the open disagreement concerned the decline in oil production of the Azeri and Chirag oil fields, which led the President of Azerbaijan Ilham Aliyev to state: *“I should note that the unexpected drop occurred only due to crude mistakes by BP, which leads the consortium operating the Azeri and Chirag fields. We have co-operated with BP for many years. At all times we have supported their activity. We supported them in their hardest days. And we expected adequate treatment. These erroneous forecasts given to us are unacceptable. The false promises given to the state oil company [SOCAR] are unacceptable. In the business world, there is no place for such a relationship, it is impossible.”*

This statement is no good news for Europe, for BP or for the Shah Deniz consortium. BP is today the most important oil major in Azerbaijan. BP has invested more than any other oil company and is by far the number one investor in Azerbaijan. An effective relationship between BP and Azerbaijan is therefore essential for the development of the Shah Deniz gas field. The relationship between President Aliyev, BP and SOCAR will affect the decision which pipeline route will eventually transit the Shah Deniz Gas to Europe. The ultimate decision lies within the President of Azerbaijan.²¹ The fact that President Aliyev, who is very experienced in the oil and gas industry, having also served as Vice-President of SOCAR before being elected President of Azerbaijan, chose the current timing for such a public statement, a few months before the FID of Shah Deniz, is a negative sign. President Aliyev has been very successful in his energy policy by bringing unprecedented revenues to his country. Not as long as five years ago, when the Shah Deniz phase one started to produce gas, no one from the European oil majors believed that SOCAR would grow so much. The financial liquidity that SOCAR has achieved has come as a surprise to many oil analysts and to experienced oilmen.

²¹ Anthony Livanios, “*Shah Deniz Gas: Key to the Southern Corridor*”, Natural Gas Europe, October 2012, www.naturalgaseurope.com/shah-deniz-gas/.

The fact is though that BP and SOCAR's strategies are progressively diverging. Gulmira Rzayeva, an energy expert at the influential Centre for Strategic Studies under the President of Azerbaijan in Baku is very clear: "Today, SOCAR, with its rapidly growing financial capabilities and strategic position of the project, is able to acquire more assets along the value chain. This allows it to control the infrastructure through which its gas will be transported to the market, where the company can also have stakes. At this stage Azerbaijan would never sell its gas at the Turkish-European border as a net crude exporter. Gas is a strategic commodity, and by using this asset wisely, SOCAR and the country can gain important geostrategic and financial leverage. The issue of controlling the perspective network is becoming increasingly urgent. Thus one can see the implicit rivalry between Shah Deniz partners, especially SOCAR and BP, over control of the strategic infrastructure. [...] BP is mostly interested in small scale, low fixed infrastructure with minimum investment and maximum short-term returns. Azerbaijan, on the other hand, is interested in scalable projects, considering the gas reserves in the fields that are currently under development."²² The continuation of any disagreement between BP and SOCAR would be a fundamental error with devastating repercussions both for the EU and Azerbaijan. This is, currently, the highest risk for the Southern gas Corridor.

Any delay of the FID of Shah Deniz entails risks both for the EU energy security and for Azerbaijan. Sixteen years have passed since 1997 when the original Project Sharing Agreement (PSA) was signed for the Shah Deniz gas field. Azerbaijan has managed to accumulate unprecedented wealth since that time, stabilized its political system and increased the standard of living of its society.²³ Azerbaijan has created an economic development which can be claimed to be an economic miracle.²⁴ Now it is the most critical timing for the realization of Southern Corridor both for Europe and for Azerbaijan.²⁵ The speed of developments in the European gas industry is enormous. Any further delay of the Shah Deniz FID means loss of billions in revenues. The challenge for Europe and Azerbaijan is to open the Southern Gas Corridor with the optimum economic and strategic impact for both of

²² Gulmira Rzayeva, "A Complicated Corridor: Gas to Europe – it's not just economics", Caucasus International, "The Caspian Energy Dance: Towards a New Age of Partnership?" Vol. 2, No. 2, Summer 2012, Istanbul, pp. 148-149.

²³ The growth rate per capita GDP in Azerbaijan was 7.3% (2002) 7.8% (2003) 8.8% (2004) 10.0% (2005) 11.4% (2006) 9.4% (2007) 9.1% (2008) source: Asian Development Outlook, cited in: Yelena Kalyuzhnova, "Economics of the Caspian Oil and Gas Wealth: Companies, Government, Policies", Centre for Euro-Asian Studies, Palgrave Macmillan, London, 2008.

²⁴ In 1992 I travelled to Baku as a member of the Monitoring Committee of the European Union for the First Democratic Elections in Azerbaijan. Since then I have travelled many times to the country, having myself witnessed an economic miracle. It is almost impossible for someone who visits Baku today to imagine how underdeveloped Azerbaijan was twenty years ago. The post Soviet years of Azerbaijan are more democratic, with higher standard of living and with stronger relations to European Union and the United States. The free market, open economic system combined with the proven oil and gas reserves have created the economic development of this country. For almost a century under the Soviet communist regime this country was living in the dark system of totalitarian nature that collapsed after the Fall of the Berlin Wall. The challenge for Azerbaijan is to further transform as a genuine democratic country and to foster sustainable economic development.

²⁵ Anthony Livanios "Fish or Cut Bait: Is there a Decisive US Policy in the Southern Corridor?" Natural Gas Europe, February 12, 2013, www.naturalgaseurope.com/us-policy-southern-gas-corridor.

them. The opening of the Southern Corridor will bring further economic development to Azerbaijan and will strengthen the EU energy security. The key to these goals is the Shah Deniz gas.²⁶

Second Risk: Geopolitical Rivalry or how Russia's South Stream makes its moves

Russia is determined to build South Stream in order to reach first the South East European markets. In December 2012 Russian President Putin himself inaugurated the beginning of the construction of the offshore section of South Stream. The Russian leader is determined to materialize this pipeline and to complete it before the opening of the Southern Corridor.

South Stream is primarily a geopolitical project, with a clear objective: bypassing Ukraine – cancelling the construction of Nabucco being the second one. Russia argues that it contributes to the energy security of Europe by diversifying its routes. The EU, on the other hand, is responding that it does not provide new sources of gas like the Azeri or the Turkmen gas. Moreover, South Stream does not even supply with new gas from Russia the South Eastern European countries.

The biggest threat to Russia's South Stream has been the Nabucco pipeline. Although, today, the geopolitical impact of Nabucco has changed with the new shorter version of Nabucco West, Russia is still aiming to make Nabucco West obsolete by providing directly gas via South Stream in the region.



Figure 6: Map of Russia, Bulgaria, Greece, Italy, Serbia, Hungary, Slovenia, Austria and South Stream (Source: Wingas GmbH 2012)

²⁶ Ibid, Anthony Livianos.

Beyond the internal commercial rivalry among the oil majors, what is at stake is a much bigger geopolitical competition between Russia and Europe through the competition between the Southern Corridor versus the South Stream, with at stake which pipeline will be the first one to deliver the natural gas to South Eastern European countries.

Russia is ahead in the game. It owns the gas, it has the financial strength to build an estimated €20 billion pipeline, and it has strategic partners: the French EDF, the German Wintershall, and the Italian ENI. If South Stream delivers the gas first, the Azeri gas from Shah Deniz will suffer the consequences. This means a smaller scale gas infrastructure all the way from Baku to the EU, less lucrative gas supply contracts for SOCAR and the Shah Deniz consortium, and weaker political agreements from the European countries.

Third Risk: the Eurozone Crisis or how to solve the (new) Greek Gordian Knot

The Eurozone crisis is not over yet. Its effect to the natural gas industry has been negative, as the gas demand for EU countries has declined. Greece, which is the Achilles Heel of the Eurozone, is at its most critical stage. Its geopolitical position is of crucial importance to the Shah Deniz gas as it is one of the only two entry points of the Azeri gas to the EU. The current privatization process of DEPA and DESFA poses another risk to the Southern Corridor due to the willingness of Gazprom to become the shareholder of Greece's gas industry. Greece is the "Gordian Knot" of the Southern Corridor: from the success of its economic policy depends the stability of the Eurozone and from the outcome of the privatization process of DEPA and DESFA depends if the Greek gas industry goes to Gazprom.

Prime Minister Samaras, who is the leader of the centre-right New Democracy, has been very effective in implementing an economic policy of austerity and has been successful in reaching the targets set by the EU, the European Central Bank (ECB), and the International Monetary Fund (IMF). However, his coalition government is weak and fragile because of the difference in political ideology of its partners, the socialist PASOK and the Coalition of the Left Party. Samaras' coalition government is challenged by the main opposition party, the far left SYRIZA, which is against the austerity policy. This toxic combination of parties will definitely produce at least one more severe crisis in the Eurozone in 2013 with two possible scenarios: best case would be that EU is overcoming the crisis with additional bail out money for Greece, worst case scenario would be a break-up of the Samaras coalition government, call for an early election, and far left SYRIZA winning the next elections. A politically unstable Greece would give an advantage to Russia. Gazprom might win the bid of the DEPA privatization. This would lead Russia to own and control a critical geostrategic industry for the Southern Corridor.

In Athens two viewpoints compete among gas industry executives and public policy makers as what the consequences would be if Gazprom, was to own the Greek gas industry. For some, it would seek to block the development of the Southern Corridor and the delivery of Shah Deniz gas to Europe. According to others, Gazprom would

provide the necessary financial strength to the Greek gas industry that will materialize investments to strengthen the energy security of Greece and consequently of Southeastern Europe, and will have to adjust to the realities of the Azerbaijani gas to Europe via the Southern Corridor. The privatization of DEPA and DESFA has therefore become a geopolitical challenge, rather than an economic one, for the Greek government. It is expected that Gazprom would bid the highest price for the Greek gas companies.

SOCAR is the other potential winner of the DEPA and DESFA privatization. If SOCAR were to win the bid for the two Greek gas companies, this would be the best development for the Southern Corridor. However, SOCAR alone is considered weak to counterbalance the political leverage that Gazprom has in Greece. The Russian company has been supplying the Greek market with natural gas for more than two decades and today 60% of the gas imports come from Gazprom.

Recently Gazprom announced that it will not pursue the Southern route of the South Stream which crosses Greece and transits the gas to Italy. Russia is focusing today only on the northern route. There are two main reasons which explain Russia's decision: first, President Putin is aiming to complete the construction of South Stream before the opening of the Southern Corridor in order for the Russian gas to go directly to the Southeastern European markets. Secondly, Russia wants to focus its efforts on Greece to win the privatization bid. Russia does not want to spread herself too thin. In both cases Russia has chosen to concentrate its efforts like a laser beam. In both cases Russia is ahead of the game. In Greece, Gazprom is the front runner in the privatization bid and South Stream is ahead of the Southern Corridor.

Conclusion

The Southern Gas Corridor is at risk if the Shah Deniz consortium continues to delay its FID. Russia is challenging seriously the implementation of the gas infrastructure for the Shah Deniz gas with the construction of South Stream. The Eurozone crisis is posing a risk to the security of gas demand. Russia is exercising growing influence to Greece due to its geostrategic position for the Southern Corridor and Gazprom is ahead to win the bid in its natural gas industry privatization. Nabucco West is the front runner for the transit of Shah Deniz gas, but TAP is the most commercially advantageous pipeline for the Azerbaijani gas. TANAP has achieved the potential co-operation of both pipelines and the support of EU.

What lies ahead for the Southern Corridor is to open the transit of Caspian gas with the Shah Deniz. Europe, Azerbaijan, the other Caspian countries, and the oil majors should focus their efforts in producing and transiting natural gas from new gas fields. The Caspian gas resources have the potential to be the most strategic supplies to the energy security of EU. The strong leadership and the effective decision making on crucial gas infrastructure, will determine the future of European energy security.

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