The Shah Deniz End Game

& the Plight of the Southern Corridor

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Abstract

The ongoing deliberation process on the pipeline project to be selected for shipping the Shah Deniz 2 gas to the European market has proved quite eventful: the familiar contenders in the Southern Corridor (Nabucco, TAP, ITGI) lost ground in favor of two latecomers (TANAP and SEEP). Conspicuously, the recent selection by the Nabucco consortium of a scaled-down version ('Nabucco West') epitomizes the saga of an ill-planned and poorly supported project of geopolitical ambitions. The present paper discusses why Nabucco has failed, and argues that the Southern Corridor can still save the day, albeit with significantly less strategic clout than initially envisioned.

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In May 2012 the Nabucco consortium submitted to the Shah Deniz partners the Nabucco West proposal, a scaled-down version of the long-discussed Nabucco project, conceived to ship Caspian and Middle Eastern gas to the European markets. One month later the proposal was officially announced as the winner for the route to Central Europe. For some, the moment simply came down to economic rationality taking precedence over an unrealistic political vision. For others, it proved once again the dominance Russia exerts over the energy market in the Caspian and Black Sea regions. Both claims are true, but there are additional and complicating factors. This paper will look at both the proximate background of this recent proposal, and at the deeper reasons behind Nabucco's failure.

The Shah Deniz Bid

Shah Deniz is Azerbaijan's main natural gas field, offshore in the Caspian Sea. It was discovered in 1999 and has estimated reserves of up to 1.2 trillion cubic meters. The field has been developed by a consortium composed of BP (25.5%), Norway's Statoil (25.5%), Azerbaijan's SOCAR (10%), France's Total (10%), LukAgip (a joint venture of Russia's Lukoil and Italy's Eni, with 10% overall), Iran's NIOC (10%), and Turkey's TPAO (9%). BP is the field's technical operator, and Statoil its commercial one.

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Production from Shah Deniz started in 2006. The gas has been delivered in eastern Turkey through the South Caucasus Pipeline, which runs from Baku via Tbilisi to Erzurum. The current stage of the field's development (known as Shah Deniz 1) provides about 9 billion cubic meters per year (bcma), mostly sold to Turkey (6 bcma), but also supplied to Georgia, Russia, as well as to Azerbaijan's domestic market. The field's full development (Shah Deniz 2) requires in excess of $10 billion in investments, and is expected to bring on-stream another 16 bcma as of 2017. This anticipated output has acquired an international political dimension, as it is intended to feed into one of the several projects competing to ship Caspian gas to the European markets through a route that circumvents Russian control. Significantly, of those 16 bcma, 6 bcma are unofficially earmarked for Turkey, which leaves a mere 10 bcma open for competition; this figure amounts to less than 2% of the EU's annual gas consumption.

By October 1, 2011, the familiar contenders for the Shah Deniz 2 production made their bids: Nabucco, ITGI (Turkey-Greece-Italy Interconnector) and TAP (Trans-

Adriatic Pipeline), all designed to connect Azerbaijan with the European markets. They all belong to the *Southern Gas Corridor* (henceforth called the Southern Corridor), devised by the European Commission (EC) "for the supply of gas from Caspian and Middle Eastern sources."[1] The deliberation on the winning proposal will take until mid-2013. To date, the process has already been eventful.

The original Nabucco plan was a grand-scale strategic project supported, albeit unevenly, by the European Union. Its size (31 bcma) also made it expensive to build and inefficient to run only based on Shah Deniz 2 gas volumes. On the other hand, the two contending 'interconnectors,' ITGI and TAP, have planned capacities of 10 bcma each, expandable to 20 bcma. They are more cost effective, since they rely on the existing Turkish gas grid, and their planned routes to south Italy are shorter than the 3,900 km Vienna-bound Nabucco. Moreover, one of TAP main stakeholders is Statoil (42.5%), also a Shah Deniz main stakeholder (25.5%). This gave TAP an economic edge when pitted against the political vision of Nabucco.

In February 2012 ITGI was dropped from the interconnectors' competition by the Shah Deniz consortium, out of concern that the Greek gas company DEPA (ITGI's stakeholder together with Italy's Edison) would be unable to fulfill its financial obligations following the country's financial crisis. Thus, for the Turkey-Italy route, TAP remained the sole candidate.[2]

Nabucco's rise and fall

Nabucco's protocol of intention was signed in October 2002 by OMV (Austria), MOL (Hungary), Bulgargas (Bulgaria), Transgaz (Romania), and Botas (Turkey). The plan was to reach full capacity (31 bcma) just in time to take over the Shah Deniz 2 gas output, i.e. in 2017. The consortium's own estimated cost of the project was €7.9 billion, but a February 2011 estimate by BP nearly doubled it to €14 billion.[3] The joint venture agreement was signed by the five partners in June 2005. In 2008, the German public utility RWE joined the group.

To understand Nabucco's motivations, we have to look to the historical gas relationship between Europe and first the Soviet Union, then Russia, starting the late 1960s. The Austrian and German imports of Soviet natural gas played a crucial role in those countries' adjustment in the wake of the 1973 OPEC oil embargo. Based

1 EC (2008), "Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan," November 13, p. 5.

2 See, among others, www.euractiv.com/energy/greek-crisis-kills-itgi-pipeline-project-news-510994, accessed April 1, 2012.

3 www.bloomberg.com/news/2011-02-22/nabucco-pipeline-may-cost-19-billion-bp-says-guardian-reports.html, accessed April 1, 2012.

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on long-term contracts (LTCs), a number of West European energy "majors" have developed long-standing and mutually beneficial relations with Gazprom. As observed by Ralf Dickel and Kirsten Westphal,[4]

> From a Western European perspective, gas trade based on LTCs at the import level have played a positive role in balancing security of supply and security of demand and in stabilizing bilateral relations. A most impressive gas infrastructure linking Russia with major Western European countries has been built. Russia has been a reliable supplier and maintained its obligations to supply the contractual volumes, and its EU partners have reliably paid their bills and have always taken the minimum pay volumes (usually about 80% of the supply obligation).

Nonetheless, for the new EU member states, energy relations with Russia have kept a Cold War ring. With the exception of Romania – which still relies on national production for about three quarters of its gas needs – the rest of these countries depend almost entirely on Russian gas supplies. On the one hand, Western Europe is criss-crossed by a rich pipeline infrastructure connected to Russia, Norway and the Netherlands. It also has an important and increasing number of LNG terminals. On the other hand, due to geographic constraints, Eastern Europe is a virtually captive consumer of Russian gas. The East European states are also more fearful of Moscow's proven inclination to use energy exports in order to exact political advantages. This is why the discovery in the early 1990s of the Caspian states' oil and gas potential raised a lot more hope about energy security in the new EU countries than in the "Old Europe."

In 2000, under Romano Prodi's Presidency, the EC established the EU-Russia Energy Dialogue, which promoted a doubling of the European intake of Russian gas. But just about the same time, the oil price entered an upward trend that was to last almost the whole decade. The LTC-based gas prices followed in that trail. This incentivized the power structures of Vladimir Putin's Russia to restore the "vertical of power" and reassert state control over the oil and gas industry. Although the ex-Soviet states have bought the Russian gas at a discount compared to the European netback (and even so in the form

4 Ralf Dickel and Kirsten Westphal (2012), "EU-Russia Gas Relations. How to Manage New Uncertainties and Imbalances", Stiftung Wissenschaft und Politik/German Institute for International Affairs, SWP Comments 12, April 2012, p. 3.

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of barter deals, e.g. gas volumes in exchange for transit fees), the rising trend of the Russian gas price upset the systems of compensation and generated increasingly disturbing political tensions between Russia and its "sister countries".

European energy security

Things came to a head between Russia and Ukraine in 2006, when a few days of gas supply cutoff brought the issue onto the radar of European consumers. Everybody in the EU started talking about energy security, in the context of a deep-seated concern about Gazprom's monopolist position. The fear was that the rising Russian imports would give rise to Europe's overdependence. On the face of it, the perceived disunity among the energy policies of the EU member states translated into disquiet about the Union's ability to pursue a common external energy policy. Hence, at the policy-making level, the rhetoric took a geopolitical slant. Starting 2008, the EC has been advancing the notion of the Southern Corridor. But until recently the commercial reality remained largely unmodified: the EU-Russia energy relation kept resting on bilateral LTCs at import level between Gazprom and a handful of West European energy majors.

The true watershed in the EU-Russia energy relationship was 2009, when several seismic events shook the European energy markets. The first was the new Russo-Ukrainian gas conflict of January 2009, this time an outright commercial war that left parts of South-East Europe in the cold for two weeks in the middle of the winter. More than anything else, this new spat animated the Southern Corridor and brought political impetus to its flagship project, Nabucco.

Lukewarm political support

The true watershed in the EU-Russia energy relationship was 2009, when several seismic events shook the European energy markets.

After a flurry of international summits, Nabucco's intergovernmental agreement (IGA) was signed in Ankara in July 2009. Conspicuously, no envisaged producer state was present. This, in retrospect, proved to be a structural vulnerability of the whole concept. In any event, other than at the level of the EC, there was no real political support for Nabucco between the leading European governments. The point was well made by Katinka Barysch:[5]

5 Barysch, Katinka (2010), "Should the Nabucco Pipeline Project Be Shelved?," Policy Brief, London: Center for European Reform, p. 3.

> Angela Merkel, the German chancellor, has been lukewarm about Nabucco and initially vetoed the EU's €200 million grant [for the initial feasibility study] to the pipeline (officially because she did not want EU stimulus money to be spent outside the EU). She later spoke out in favor of Nabucco, but only after the EU reconfirmed its support for the German-Russian led Nord Stream – despite visceral opposition from Poland and other member-states. Neither has Nicolas Sarkozy been a champion of the Southern Corridor. The Turks … had rebuffed Gas de France's offer to join the Nabucco consortium. Sarkozy now seems to prefer that France's big energy company join forces with Gazprom: Gas de France joined the Nord Stream project in March 2010 while Electricité de France is rumored to be talking about participation in [Gazprom's] South Stream. …Silvio Berlusconi also prioritizes bilateral relations with Russia. Italy's ENI is Gazprom's main partner in South Stream.

As shall be described below, only in the fall of 2011 did EU support for Nabucco become substantial, but it was too little and too late.

Second, the 2009 ex-Soviet gas standoff raised EU-wide awareness about the low interconnectivity between the gas grids of the member states, especially with and within Eastern Europe. Accordingly, a concern for the integration of Europe's various regional energy markets became widespread. This dovetailed with the idea of having liberalized and unified utility markets of continental scale. And indeed, the Third Energy Package (TEP), approved by the European Parliament in September 2009, comprises a set of directives and regulations aimed at creating open and competitive markets for electricity and natural gas. In order to avoid a situation in which major energy producers exert exclusive control on the transport networks and thus block the competitors from market access, TEP demands "ownership unbundling," i.e. dismantling the vertically integrated companies by separating the transmission from the supply business.

The implications of the American 'shale gas revolution'

Third, 2009 also saw a tectonic shift in the global energy market: 'the shale gas revolution' in the United States. By 2009, one-third of the U.S. domestic natural gas production came from unconventional sources, and one year later America equaled Russia in the world's ranking of the biggest gas producers. This shift has been momentous for the market dynamics everywhere else in the world. For one thing, America stopped importing natural gas. Hence, large LNG volumes initially destined for the North American market have been diverted mainly toward Western Europe, which has the geographical, technological and economic intake capacity for LNG imports. Meanwhile, though, due to the economic crisis the overall energy consumption in the EU had slumped. The aggregated effect was a "gas glut" and a price drop in Western Europe, with significant repercussions upon the old EU-Russia gas trade system. As aptly expressed by Dickel and Westphal[6]

> Prices on the developing northwest European gas spot markets plummeted with the arrival of large Qatari LNG in mid-2009. The flipside of this comfortable situation was that gas prices of oil-indexed long-term contracts (LTCs) were substantially higher: At their lowest price levels in August 2009, UK National Balancing Point prices were at about 8€/MWh, compared with about 16€/MWh under import LTCs. Thereafter, spot prices tended to increase more than LTC prices, still leaving a substantial gap of several euros per MWh.

Over the last few years, one effect of this situation was the corrosion of the economic basis for the LTCs-based partnerships between Gazprom and the European energy majors. Increasingly, they have started to push Gazprom to concede a spot-based price component in those contracts. In effect, due to the steady price differential between the oil-indexed and the hub-based pricing systems, there is at least a short-term incentive for the European importers to drop the oil-indexation of natural gas altogether. The pressure seems to be so significant that Sergei Komlev, Gazprom's Head of Contract Structuring and Price Formation, took pains in a recent paper to argue for the advantages of the current "hybrid" system, that combines oil-indexation and the hub-based reference in a mutually balancing mechanism.[7]

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South Stream, Nabucco's nemesis

Yet another reason why Nabucco has been lingering for almost 10 years, with sporadic ups and downs,

6 *Dickel and Westphel, idem, p. 2.*

7 *Komlev, Sergei (2012), "European Gas Market Reforms Undermine Security of Supply," European Energy Review, May 7.*

was the behavior of its own member countries, which one by one jumped on the South Stream bandwagon, the very project that Gazprom contrived in 2007 basically to block Nabucco and generate political leverage against Ukraine's ability to halt the transit of Russian gas exports to Europe.

South Stream AG is a joint venture of OAO Gazprom (50%), Italian company Eni SpA (20%), German Wintershall (15%) and Electricité de France (15%). It is a mammoth project whose central piece would be a 900 km-long pipeline on the Black Sea's seabed, from Russia to Bulgaria. From there it would branch out in two onshore routes: one heading to Austria, and another one to southern Italy, via a Greece-Italy marine interconnector. Taken at face value, South Stream is hugely difficult, both technically and financially. The planned capacity was boosted from an initial 31 bcma to 63 bcma[8] at a prohibitive initial cost of €24 billion, according to Gazprom's own estimate. According to the project's website, South Stream is "aimed at strengthening the European energy security" by eliminating "transit risk," as "another real step toward executing the Gazprom strategy to diversify the Russian natural gas supply routes."[9] But this is hard to believe, as it stands to reason that Gazprom would not want to lose any European market shares, not to mention its grip on the Caspian Basin gas production. The inherently political goals of the South Stream project are essentially transparent: (a) to rid Gazprom of its dependence on the Ukrainian gas transit system and to leverage Moscow's relationship with Kiev;[10] (b) to discourage Nabucco's – and more generally, the Southern Corridor's – progress, at least in any sizable configuration.

In fact, although it pre-dates South Stream in terms of its conception, Nabucco evolved reactively during its more substantive developmental period, typically in attempts to control the damage inflicted by South Stream proposal, though also the impacts of the other Southern Corridor competitors. Between 2008 and 2010 a campaign of successive defections by every single Nabucco government unfolded. First, Hungary and Bulgaria, then Austria and Turkey, and finally Romania have in various forms – either by ratifying IGAs for the construction of pipeline segments on their respective territories or by

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8 dpa (Deutsche Presse Agentur) (2009), "Gazprom Agrees to Boost Pipeline Capacity," May 15.

9 http://south-stream.info, accessed April 1, 2012.

10 Indeed, in 2007, since launching the South Stream concept, Gazprom has repeatedly argued for the need to bypass the "unreliable" Ukraine in the interest of European energy security.

authorizing the use of their seabed portions, or just by displaying eager interest and readiness to be included – jumped over into the South Stream boat. Serbia, Slovenia and Croatia also signed IGAs for the construction of South Stream.[11] Meanwhile, Electricité de France and Wintershall joined the consortium, siding with ENI in a lineup of important Western energy companies that contributed to the overall credibility of the joint venture.

No doubt, South Stream has been cunningly used by Moscow as a political and diplomatic instrument, effectively implementing a strategy of *divide et impera* among Nabucco's Central and East European governments. But even with these apparent successes and in spite of Gazprom's recently intensified promotional campaign,[12] there is still little ground to consider South Stream a *bona fide* project. Its enormous financial costs and supply volumes (from still unidentified sources) would demand a suffocating degree of economic effort – especially when seen against the background of the current unpredictability of the European gas markets, with little investor appetite for large scale trans-

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national pipelines. Besides, it would be largely redundant, especially after the first leg of the Nord Stream pipelined was commissioned in September 2011, thus effectively contributing to the Ukraine-bypass strategy.

EU energy diplomacy, too little and too late

The EU-level more substantive political support for Nabucco did eventually arrive, but it was tardy and barely convincing. In January 2011, the EC President, José Manuel Durão Barroso, together with the Energy Commissioner, Günther Oettinger, visited Baku and Ashgabat in support of the Southern Corridor. Then, in September 2011, the EC presented a concept of common foreign policy action with regard to Europe's energy providers.[13] As a practical follow-up, one week later the Commission offered to mediate between Azerbaijan and Turkmenistan to speed up the construction of a trans-Caspian gas pipeline, fundamental to the viability of the Southern Corridor – stirring

11 For a detailed account, see Radu Dudau (2010), "Eurasian Energy Security: Recent Trends in the European Game of Natural Gas Projects," Bulletin of the Slovenian Armed Forces, June 2010, pp. 111-132.

12 In February 2012, the Gazprom CEO, Alexei Miller, announced that a final investment decision on South Stream was going to be made by November 2012. The deadline for the pipeline launch is later in 2015 (RIA Novosti (2012), "South Stream Investment Decision Due in November", Feb. 15, http://en.rian.ru/business/20120215/171327667.html, accessed Feb. 16).

13 COM 2011, 537 final, "On security of energy supply and international cooperation – The EU energy policy: engaging with partners beyond our borders."

nervous comment from the Russian Ministry of Foreign Affairs.

Disputing the juridical status of the Caspian Sea, Russia (which, along with Iran, it considers a condominium, i.e. a territory over which sovereign rule is formally shared) claims the right to veto any infrastructural venture that would cross the sea without the benediction of all five riparian states. In practice, this has been an efficient political tool for keeping gas-rich Turkmenistan outside out of the European energy security-enhancing projects. Thus, insofar as the EU proved incapable of combining a political vision with a properly considered financial package in order to bring Turkmenistan into the Southern Corridor, the game was shaped by the commercial interests of private investors acting under geopolitical constraints set by Russia. Nabucco, originally designed to draw on Caspian and Middle Eastern natural gas, found itself fighting with more nimble competitors for a meager 10 bcma. This certainly looked like putting the cart before the horse.

More importantly, in October 2011 the EC President announced a major infrastructure investment plan called "Connecting Europe," envisaging the allocation of €50 billion from the EU 2014-2020 budget for transport, energy, and communications infrastructure. Out of that, €9.1 billion are to be invested in energy transport infrastructure and climate protection. The idea is to define "projects of common interest," speed up their approval procedures, and secure the required funding. EU funds combined with European Investment Bank financing are deemed to "reduce the risk for third party investors" and mobilize additional "long-term private sector debt financing".[14] Now, the €9.1 billion amount is several orders of magnitude higher than the amounts available so far through the Trans-European Networks-Energy (TEN-E) program. Nonetheless, there has been no sign yet that these considerations made any difference in Baku in the ongoing Shah Deniz 2 decision-making process.

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TANAP, SEEP, and Nabucco West

Two late contenders in the Shah Deniz bidding have emerged with the best winning chance. First, BP made its own offer for the Shah Deniz gas (a field it also operates and owns 25.5%), namely a project called South East Europe Pipeline (SEEP). SEEP's idea is to upgrade the Baku-Tbilisi-Erzurum pipeline from the current 8.8 bcma to the full projected 20 bcma (just enough to accommodate the extra 10 bcma

14 http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/707, accessed April 1, 2012.

at stake) and then build a line from eastern Anatolia to Vienna, more or less following Nabucco's track in a smaller and cheaper version.

Like ITGI and TAP, SEEP was "nonstrategic" in the political sense, with a narrowly conceived commercial rationale. Such projects cannot make a sizeable contribution to EU energy security, as the commercial interests alone are unlikely to overcome the political hurdles that stand before a trans-Caspian line. Yet by now it is obvious that a turn was made within the Southern Corridor framework toward such proposals, i.e. towards the more commercially driven and less "strategically" minded. This, of course, is not to say that political gaming has ceased; for instance, it is plausible to look at SEEP as a gambit

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through which BP will indirectly pursue more distant objectives. In a telling comment, Mathew Hulbert suggests a possible political rationale:[15]

> In tabling the SEE Pipeline, BP may have decided to have a bilateral discussion with Moscow. BP knows how important South Stream is to Moscow's structural designs over European gas – just as much as Moscow knows how crucial an upstream Arctic stake is for BP. So business can be done.

Although speculative, this seems to make sense, as it is aligned with a general reticence among the Western energy companies to upset Moscow's desire to retain its practical monopoly over gas shipping in the Black Sea Region. In a more recent paper, as well as admitting that SEEP may be a *bona fide* commercial proposal, Hulbert suggests a more proximate goal that BP might have had within the Shah Deniz negotiations:

> You could ask the serious question whether the likes of BP would ever want to get bogged down in protracted pipeline politics, but the BP 'offer' has undoubtedly got things moving elsewhere. It's no surprise that Ankara quickly came up with its TANAP proposals, with Botas and SOCAR *both* happy to offer BP a stake in the game. Just as importantly, the original Nabucco consortium has magically come up with a slimmed down Nabucco West project.[16]

In effect, quite a while after the

15 Hulbert, Mathew (2011), "BP Drives Stake Through the Southern Corridor", European Energy Review, Oct. 6.

16 Hulbert, Mathew (2012), "European Gas: How Not To Do Pipeline Politics", Forbes, April 9.

October 1 bid deadline, a new project came to the table: a joint Azerbaijani-Turkish proposal made in December 2011, capitalizing on the two governments' key role in the Shah Deniz end-game. Known as TANAP (Trans-Anatolian Pipeline) in Turkey and TAGP (Turkey-Azerbaijan Gas Pipeline) in Azerbaijan, this pipeline project is to ship up to 30 bcma from eastern to western Turkey, with the prospect of being continued from the Turkish-Bulgarian border up to Central Europe. The estimated end of construction is 2017, at a cost of $5 to $6 billion. Baku will cover 80% of these costs, and Ankara the rest. TANAP is projected to have a scalable capacity, has secure financial resources, and has Azerbaijan and Turkey as main political and commercial partners, thus making for a legal and financial framework much more responsive to the interests of these two states than any competitor.

On 26 June 2012, Baku and Ankara signed the TANAP Intergovernmental Agreement, following what must have been lengthy and difficult negotiations. On the one hand, it became obvious that SOCAR wants a midstream presence in the value chain – and, in retrospect, it is hard to fathom why the Nabucco partners blatantly neglected this interest. Turkey, on the other hand, wants TANAP to abide by its national juridical terms and to increase its participation in the joint venture. To this purpose, Ankara had been upping

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the ante by increasing its imports of Russian and Middle Eastern gas.[17] Ankara and Baku were not for the first time at loggerheads; in fact, a protracted pricing debate over the gas that Turkey imports from Azerbaijan extended from 2007 to 2010. But Azerbaijan's ambition to play a larger part in the "pipelines game" as well as Turkey's aim of becoming a true energy hub,[18] did, as expected, both prevail. As a side effect of TANAP's progress, the chances of SEEP were effectively nullified.

With respect to the advancement of the Southern Corridor, this new Azerbaijani-Turkish IGA differs in scope from the old Nabucco international transit regime, aligned to EU regulations. Hence, TANAP will stand as a distinct segment on the way from the Caspian Sea to Europe, serving autonomous goals. Consequently, the EU is no longer the unconditional destination of the Shah Deniz II gas.

Prior to the Nabucco West concept, the factors that led to Nabucco's loss of credibility triggered reactions of

17 Hulbert, Mathew (2012), "Azerbaijan, Knock, Knock, Knocking on Europe's Door," European Energy Review, May 21.

18 Such a role can only be enhanced by the massive recent discoveries of hydrocarbons in the Eastern Mediterranean.

outright disaggregation. In April 2012, Hungary's MOL, one of the Nabucco's original shareholders, refused to accept the consortium's 2012 budget proposal, expressing preference for a "reconsidered Nabucco."[19] Then, after having manifested already in January 2012 its willingness to collaborate with TANAP in order to secure "access to Caspian gas resources for Europe in the most economic way,"[20] RWE considered the possibility of quitting Nabucco altogether, due to the project's estimated doubling of costs.[21] Recall that RWE has suffered a severe economic blow because of the German government's decision to decommission the nuclear energy plants by 2022. Finally, Austrian OMV also contemplated a shorter version of Nabucco.

As noted, the Nabucco West proposal was tabled in May 16, 2012.[22] The move was praised by Botas,[23] whose executives have all along seen in Nabucco West the optimal extension of TANAP. As a significant detail, the announcement of the Nabucco West selection was made on June 28, only two days after the TANAP IGA was signed. Nabucco West is basically a scaled-down and shorter version of the initial Nabucco proposal. The new plan is of a 10 bcma-large, yet scalable pipeline, running 1,300 kilometers from the Turkish-Bulgarian border to Baumgarten, near Vienna. It will rely on the already established legal framework of Nabucco: the IGA of 2009, the Project Support Agreements signed with the individual governments in 2010, and the Third Party Exemptions from the requirements of the Third Energy Package.

Thus, while TANAP is by now virtually sure to ship Azerbaijani gas over Turkish territory from east to west starting 2017, the further gas conduit to Europe will have to be chosen by the Shah Deniz partners between Nabucco West and TAP. A final decision in this respect is expected by May 2013. However, when comparing the relative prospects of Nabucco West and TAP, the former has definitely a better stand. While TAP's competitive advantage derives from Statoil's vested interest in controlling both the production and the distribution of the Shah Deniz 2 gas, TAP is much less elaborated than Nabucco West: it is not advanced in terms of agreements and legal permits, while its competitor inherits the whole legal and regulatory infrastructure already put in place for Nabucco. Then, TAP addresses the Italian gas market which, although

19 Peto, Sandor (2012), "MOL rejects Nabucco budget on doubt on pipeline," Reuters, April 24.

20 Gloystein, Henning (2012), "Nabucco gas pipe's prospects slim after RWE move," Reuters, January 19.

21 Spiegel (2012), "RWE plant Rueckzug aus Nabucco-Konsortium," May 13.

22 Nabucco Pipeline International GmbH (2012), Press release, May 16,

www.nabucco-pipeline.com/portal/page/portal/en/press/press_release#, accessed May 16

23 upi.com (2012), "Ankara Assumes Nabucco West Will Win," May 16

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currently marginally more profitable than the northern European ones, is nonetheless well provided and has ample diversification options. By contrast, Nabucco West retains the strategic value of supplying the Central and East European countries, much more dependent on Gazprom, which ostensibly pay significantly higher prices for the Russian gas than their West European counterparts. Besides, from the Baumgarten an der March hub (Nabucco West's terminus point) the German gas market will also be supplied with Azeri gas; RWE and BayernGas are interested buyers, and the latter intends to join the Nabucco consortium, too.[24]

Conclusion: the fate of the Southern Corridor

On balance, the "old" Nabucco is as good as dead, and with it, the concept of a single large-scale gas pipeline linking the Caspian Basin with the EU markets. What is left instead are a couple of smaller-scale proposals in terms of capacity and length, essentially commercially driven. While TANAP looks like an unrivaled contender for the Turkish segment of the route to Europe, things are less clear with the two possible continuations. Each of the competitors has corporate interest behind it: SOCAR and Botas stand for Nabucco West and Statoil for TAP. And politics will also play a role, as the terms that these companies offer the transited states are going to be factored in. In any event, the process has to get moving as soon as possible, because as Friedbert Pflueger points out,[25]

> the Shah Deniz field is being developed pursuant to a production sharing agreement (PSA) signed in 1999, subject to a finite term in 2036. Even with the recent five-year extension, the consortium will only have two decades to recover its costs and make a profit assuming that full production from Phase II of Shah Deniz is delivered to Turkey and the EU by 2017-18. The Shah Deniz shareholders are therefore under a serious 'time crunch' to accelerate the selection of gas buyers and transportation pipelines.

But once the Shah Deniz final transport solution has been put

24 Reuters (2012), *"BayernGas Keen on Nabucco as Uncertainty Looms," April 25; The Moscow Times (2012), "Nabucco Looking for New Investors," July 1.*

25 Pflueger, Friedbert (2012), *"The Southern Gas Corridor: Reaching the Home Stretch," European Energy Review, January 12*

together and the required financial, technical, fiscal and legal measures are in place, the Southern Corridor will be vastly different than initially intended. Seen from a geopolitical viewpoint, the Southern Corridor is largely a failure. It was designed from a geopolitical perspective, to bring sizeable quantities of Caspian and Middle Eastern gas to Europe, significant enough to make a difference to the EU security of supply; yet the 10 bcma at stake make up less than 2% of the yearly EU gas consumption. Then, it was expected to build a transport conduit independent of Russian control; yet Russia remains structurally dominant in the energy business environment of the Caspian and Black Sea basins. And by the look of things, the expected configuration of the Southern Corridor is unlikely to be able to tap into Turkmenistan's enormous gas resources. In hindsight, the EU manifested a structural inability to project geopolitical power. To put it bluntly, Brussels was simply unable to put its money where its mouth was.

Instead, the Southern Corridor survived and progressed as a primarily commercial concept, driven by the interests of suppliers, transporters and consumers of natural gas. If Nabucco West extension gets finally chosen, the Corridor can still play a strategic role, albeit a modest one, by transiting and supplying Bulgaria, Romania and Hungary – countries that currently depend on Gazprom either as a monopolist exporter, or dominant supplier, or both. In the longer term, however, the Southern Corridor's outlook will fundamentally depend on the evolution of the European gas markets. If it proves profitable to ship greater volumes of Azerbaijani gas[26] to Europe, the Corridor will be scaled up to its technical limits and may well comprise both Nabucco West and TAP.

But technologically advanced and investor-friendly Europe will also pursue distinct strategies of increasing its energy security. The evolution of the technology along with the proper legal and fiscal regulatory framework are likely to open new sources on the supply side (such as shale gas and new offshore production sites, as well as new LNG import terminals) and lead to changes on the demand side (such as increased energy efficiency or preferential and demand for "green energy"). More broadly, it will lead to a significant redistribution of weights in the energy mix. While the EU's decarbonization goals are already

Each of the competitors has corporate interest behind it: SOCAR and Botas stand for Nabucco West and Statoil for TAP.

26 France's Total announced in September 2011 that Azerbaijan's Absheron offshore field holds reserves of around 350 bcm of gas and 45 million metric tons of gas condensate (Wall Street Journal, Sept. 12, 2011). According to SOCAR representatives, production from Absheron could start as early as 2016-2018.

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constraining the process, the extent to which Brussels and its external energy suppliers manage to put in place a system of mutual incentives will be definitive for the continent's energy security.