Trouble in the pipeline

Ana Stanič explains how Europe's gas security project failed and the lessons that should be learnt

Diversification of gas supply has been a strategic priority for the European Union since its dependence on imports began to grow in the early 2000s. The crisis in Ukraine has heightened concerns that the flow of Russian gas passing through this country may be interrupted and has reignited calls for dependency on Russian gas to be reduced. As a new European Commission takes over energy policy in Brussels, it is worth examining the lessons the EU ought to learn from the Southern Gas Corridor project, which for a decade was seen as key to enhancing energy security.

As late as 2013, the Southern Gas Corridor was regarded, at least by the EU commission, as synonymous with the Nabucco pipeline project. Nabucco, named after the Verdi opera which tells the story of a Babylonian king who converted to Judaism after being outmanoeuvred by his Hebrew captives, was conceived in 2002 as a way to link the EU gas market to the world's largest gas deposit in the Caspian/Middle East basin. The project was led by a consortium of six energy-buying companies, from Austria, Hungary, Bulgaria, Romania, Turkey and Germany.

At its most ambitious, the Nabucco pipeline was to span more than 3,900km, cross five countries and bring 33 billion cubic metres of gas a year to the EU from Azerbaijan, Turkmenistan, Iraq and Iran – some 8 per cent of EU's gas demand at the time. With the EU importing about 120 billion cubic metres of gas a year from Russia, of which 25 per cent passes through Ukraine, the commission saw Nabucco as the silver bullet that would eliminate Europe's dependencies as to route and source of gas. If only things were that simple.

Encouraged by the United States, the commission ignored all concerns about the bankability of the project. It insisted that the consortium own the pipeline along the entire route from the eastern borders of Turkey via Bulgaria, Romania and Hungary to Baumgarten an der March in Austria. In July 2009, an inter-governmental agreement was signed between Austria, Hungary, Bulgaria, Romania and Turkey under which Ankara agreed that the part of pipeline going through its territory would be governed by EU law, a key requirement of the EU.

The commission never hid its preference for Nabucco over other possible projects. In December 2003 it gave it a generous grant towards the cost of the feasibility study. It appointed a Nabucco coordinator in 2007 to secure political support. Everything changed, however, in November 2011. The commission was taken by surprise when Azerbaijan and Turkey agreed to transport Azeri gas to the EU-Turkish border via a new pipeline or through the existing network of Botas, the Turkish gas company. The following year, the two countries signed an agreement to create a Trans-Anatolian Pipeline (Tanap) under which 6 billion cubic metres a year of gas from the Shah Deniz 2 field in Azerbaijan was to flow to Turkey and only 10 billion cubic metres a year to the EU. The Southern Gas Corridor now had a non-EU element to which no EU gas buyer was a party. Moreover, under this agreement Turkey was granted a right to buy any additional Azeri gas that became available in the future.

Outmanoeuvred, like the protagonist of the eponymous opera, the now considerably shrunken Nabucco project was renamed Nabucco West – since it now started on the Turkey's western border with Bulgaria.

By this point in time other commercially driven projects, including the Trans-Adriatic Pipeline (TAP), which planned to transport gas from Turkey's western border to Italy, were quite advanced in their negotiations with the Shah Deniz 2 consortium. The commission, however, still continued to back Nabucco West.

Outmanoeuvred again

Both Nabucco and the commission insisted the Shah Deniz 2 consortium should prefer Nabucco West. They argued that it had two key advantages: the first was that the 2009 inter-governmental agreement provided the most advanced legal framework. The second that Nabucco had been granted an exemption from having to offer third parties access to 50 per cent of the pipeline under the Second Energy Package in 2008.

However a shrunken and delayed project meant that these needed to be revisited: Turkey, which had been party to the 2009 agreement, was no longer involved; the entry points named were on the wrong border of Turkey, its eastern side; and the exemption granted to the consortium needed to be extended and updated in view of the adoption of the Third Energy Package. Fearing mistakenly that such a revisit would weaken Nabucco West, the commission resisted doing so.

On May 17, 2013, less than a month before the Shah Deniz 2 consortium was to

STUARTCONWAY / BP

A worker on a BP Platform in the Shah Deniz gas field, Caspian Sea

announce which pipeline would transport its gas to the EU, the commission extended the exemption to Nabucco West in an attempt to address these concerns. By then, TAP had become the front runner in the race. And in early June the Shah Deniz 2 consortium duly announced that TAP would transport its gas to the EU.

Lessons to be learnt

There are four lessons that ought to be learnt. First, despite the commission's efforts, in the end the project that made more sense commercially won out. The BP-Azerbaijan executive responsible for developing the Shah Deniz 2 gas field, vice-president Al Cook, described TAP as 'significantly more efficient than Nabucco-West from a gas price and tariff point of view'.

The commission must learn that its role is solely to ensure a stable legal framework and provide a level playing field for energy companies to operate in.

The second lesson is that any future pipeline project to bring gas to Europe will need to be supplier-led. The Shah Deniz 2 consortium, which includes some of the largest gas suppliers, now has a stake in TAP and Tanap. The idea that a pipeline owned by buyers of gas could be bankable was unrealistic from the start.

Third, an energy project needs a well-defined legal framework. The expectation that energy companies looking to invest more than €40 billion to bring gas from Azerbaijan would accept the risk associated with the legal fudges in the 2009 intergovernmental agreement suggests a lack of understanding of how companies operate in a non-digiriste market.

Fourth, it must be acknowledged that the Southern Gas Corridor has not achieved the objective of diversifying routes and sources of gas. Only 10 billion cubic metres of Azeri gas is expected to arrive in the EU from 2019 onwards. This is less than a third of what was promised when the project was first developed and represents about 2 per cent of the EU's current demand. Future EU energy strategy must be based on commercially reliable and viable assessments.

It is unclear, however, whether any of these lessons have been or will be heeded. Recently calls were made for an Energy Union – a 'single European body charged with buying its gas' – to be set up. Similar calls were made in 2010. At that time they were dismissed as incompatible with EU competition law

The Ukraine crisis is being invoked as justification for such a union. Some argue that the EU is on the brink of war and that an Energy Union is justified as an emergency measure. However, data from Platts-Bentek, the energy information provider, shows that the Ukraine crisis has had no effect on the price of gas in the EU. Russia's share of gas imports to the EU has, in fact, increased in 2014, as it has stepped in to cover shortfalls in deliveries from Norway and Algeria.

One can only wonder, then, why the incoming commission president, Jean-Claude Juncker, is appointing a commissioner for the Energy Union. To those of us who grew up under communism, he seems to be toying once again with an idea that smacks of a centrally planned economy.

If the EU adopts this approach, it is difficult to see how it will attract the €1 trillion worth of investments in energy infrastructure that it says are needed by 2020 to achieve energy security and ensure economic growth. EU energy law and policy must not be allowed to become a deterrent to energy investment.

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