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Strategic Reshuffling: The Southern Gas Corridor after ITGI's Elimination

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On 20 February BP announced on behalf of the Shah Deniz subsidiary that is examining the offers of the four alternative candidates for the transportation of the 10 bcm/y of Phase 2 production to Europe, that "there will be negotiations with Trans Adriatic Pipeline and also further clarifications on Nabucco and South East Europe Pipeline, but ITGI is no longer being considered". A BP spokeswoman also told *DowJones* on 18 February that "the Socar-led [Azerbaijan's state-controlled energy company] negotiating team has made the decision to undertake exclusive negotiations with TAP on a southern pipeline route through Italy" while noting that ITGI's proposal "will not be considered further".

Harry Sachinis, the CEO of DEPA, characterized the consortium's decision as "temporary" noting that the ITGI is still the most viable and mature project of the contestants. Edison put on a similar face as did the Greek and Italian governments who remain committed to their 2007 Intergovernmental Agreement or IGA, but in reality it had been clear for months that the ITGI pipeline was unable to meet the scalability criterion of the SD2 consortium while the general financial condition of Greece had created the strong impression in several SD shareholders that DESFA, the state owned TSO/Transmission System Operator, would not be able to finance the EUR 1 billion onshore component of the ITGI project that run through 900km of mainland Greece. More importantly, Edison's price offer, which would have reserved up to 80 % of the pipeline's capacity, did not live up to SD2 expectations.

TAP noted in a written statement that it "would now enter into exclusive negotiations with the Shah Deniz partners in on progressing the project" emphasizing that "TAP route to Italy offers the Shah Deniz consortium the most attractive market and the most advanced gas evacuation route". DEPA and –more importantly- the Mytilineos Group could have already expressed their interest regarding their participation in TAP with a 10-15 percent share, even though it is as yet unclear what would be the position of the Greek government which would need to authorize, in DEPA's case, such a potential participation. DEPA is not considered the most likely candidate for a partnership with TAP since it is formally under privatization since 29 February 2012.

TAP has repeatedly said that it would be open to the incorporation of a Greek partner. As early as 1st February Michael Hoffmann, the External Affairs and Communications Director of the Trans Adriatic Pipeline project told a press conference held in Athens that "TAP is ready to work with ITGI holders in the event that TAP is chosen by Azerbaijan to transport gas to Europe from the second stage of Shah Deniz gas field development" (*Middle East Economic Survey*, 06/02/2012). Attracting Mytilineos into TAP may be a challenge for Trans Adriatic but from the consortium's perspective the alluring of a major Italian company such as ENEL is far more important and crucial in order to secure Italy's political support.

Equally important is the announcement of a new timetable for the SD2 decision that could likely extend into mid-2013, the deadline set by the consortium for its FID (Final Investment Decision). BP told *DowJones* on 20 February that "the next decision will be between Nabucco and SEEP, which is partially supported by BP. "Once that [decision] is done, it will be possible to make a decision between a northern [to Central Europe] or southern [to Italy] pipeline route". It is not yet clear on when such a decision would be reached even though combined reports indicate that the process would extend over a number of months, not weeks. **What is clear though is that the original timetable for the final selection of the evacuation route, which was set for April 2012, no longer applies.**

One of the reasons for this extension is the structural modification of the Nabucco proposal which is most likely to drop its entire Asian component and be redrawn as an entirely new pipeline starting from Edirne in European Turkey to Baumgarten in Austria. Christian Dolezal, the spokesman of the Nabucco consortium, told *DowJones* on 20 February that Nabucco partners "are in the process to calculate several scenarios, including different sizes in terms of capacity and length of the pipeline. However, our preferred scenario still is the base-case and no final decisions have been made, yet", he noted.

On 22 February Dolezal still insisted that a potential feeder of Iraqi gas would remain a significant and viable option, given the fact that Nabucco shareholders, OMV and MOL are part of the consortium developing the Chemchemal and Khorr Mor blocks in the Kurdish Iraq. "Why shouldn't we pipe gas from Northern Iraq," said Christian

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Dolezal in an interview with *Dow Jones*, noting that "The consortium still remains focused on its primary project of a major pipeline to carry Caspian natural gas to Europe". Dolezal emphasized that "the demand is here in Europe. Northern Iraq has huge potential as a gas producer. We should explore that as an option to secure future gas supply for Europe".

SD partners, and most notably SOCAR and Botas, which are promoting the TANAP pipeline along the same route as Nabucco's Anatolian component, will not likely entertain an Iraqi or for that matter a Turkmen supply option. The Nabucco West or Nabucco Europe alternative, a project scalable to at least 20 bcm/y, will be *exclusively* dedicated to the long term needs of the Azeri SD partners, which are also the leading upstream developers of Azerbaijan's post SD2 production generated from recently discovered offshore fields such as Absheron (Total, SOCAR, GdF), Umid/Babek (SOCAR) and Shafag-Asiman (SOCAR-BP). A Nabucco project as a multiple import sources pipeline would no longer be accepted by Azerbaijan for strategic reasons as Baku appears to have lost all interest in the transit of Turkmen gas through Shah Deniz-owned infrastructure.

On 22 February Gerhard Roiss, OMV's CEO, after confirming that Nabucco "remained open to other solutions as long as gas would be delivered to Europe via the gas hub in Baumgarten" told reporters that "the consortium (developing the field) has told us that they will definitely decide by middle of 2013". He also linked the discovery of a significant gas field in offshore Romania with the prospective development of Nabucco. On 22 February OMV owned, OMV Petrom SA and the subsidiary of ExxonMobil in Romania, ExxonMobil Exploration and Production Romania Ltd, discovered a major gas field of 1.5 to 3 trillion cubic feet, of in situ reserves in Romania's Neptune Block. The field could start producing by the end of the decade "at the earliest" even though it was not still clear from the available data whether the field was actually exploitable. Roiss did note though that a discovery of this size "needs an international pipeline such as Nabucco", while emphasizing that "This may be the biggest find in OMV's history and added that the discovery might affect Nabucco's future".

Turkey Champions Nabucco/TANAP Merger

On 28 February Taner Yildiz, Turkey's Energy Minister revealed that the idea for a merger of the SOCAR-Botas proposed TANAP pipeline and Nabucco was on the agenda of a Nabucco shareholders meeting that took place the very same day in Vienna. Yildiz told *CNBC-e* that a potential merger should not be excluded, noting that despite Turkey's commitment to the Nabucco pipeline, it would honour its 20 percent participation in the TANAP JVC which it will establish with SOCAR by April 2012. Yildiz said that "I don't think there is any need for the Nabucco consortium to come up with a new proposal in order to link up with TANAP" stressing that "TANAP would greatly simplify the process of exporting Shah Deniz gas to Europe".

Reinhart Mitschek, Managing Director of the Nabucco pipeline consortium, told *Trend News* on 28 February that "we confirm that there is a regular shareholders meeting of the Nabucco shareholders in Vienna today. Shareholders meetings take place on a monthly basis and we discuss the project related topics" adding that "Nabucco has provided an offer to SD2 for transport services from the Georgian/Turkish border to Baumgarten in Austria. So far this concept has not been changed". As already noted, the idea is likely to have been received with skepticism from OMV and MOL due to their presence in Northern Iraq.

Germany's R.W.E., which has no presence in Iraq but is developing Turkmenistan's offshore Block 23 and could have the deciding vote on a potential merger, is waiting SOCAR to clarify the technical details of the TANAP pipeline. TANAP is planned with a minimum transit capacity of 16 bcm/y, just enough to serve Shah Deniz 2, but could expand up to 31 bcm/y. In that case RWE might be able to squeeze in through TANAP its prospective Turkmen production that is anyways unlikely to come on stream before Shah Deniz Phase 2. Alternatively, RWE could also speed up its development of the Nakchivan gas field that SOCAR would be far happier to transport via TANAP compared to any Trans-Caspian gas from Turkmenistan.

In any case Nabucco's shareholders may be running out of time and out of patience. On 24 February MOL's CEO, Jozsef Molnar told reporters during a press conference in Budapest that "For the time being, there is no obvious source of gas and there is also much uncertainty about the volume of the necessary investments. As such we can't even begin to discuss the project's returns". That same day in an effort to reduce this uncertainty Iraq's Oil Minister, Asym Jihad told *Trend News Agency* that "Iraq's officials have repeatedly stated that the country is interested in participation in this project", although he noted that "Iraq plans to begin supplying no earlier than 2015-2017" while expressing his certainty that "the differences between the Iraqi government and the government of Kurdistan's regional administration will not affect the export of Iraqi gas".

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The SEEP Parameter

Two additional parameters are also likely to sustain the uncertainty surrounding Nabucco's exact proposal to the Shah Deniz consortium until a decision on the Baumgarten-bound "finalist" is taken by the SD2 negotiating team (SOCAR, BP, Total and Statoil); a decision that could be taken as early as May or June 2012. The first and most important parameter relates to BP's rather nebulous *Southeast European Pipeline or SEEP* which aspires to bring at least 10 bcm/y of SD2 gas to the Balkans, without specifying if any of these quantities will reach Baumgarten. In an interview with *Middle East Economic Survey* published on 5 March, Toby Odone, a BP spokesman, clarified that the BP-led project has not yet finalized SEEP's, length, investment cost, TPA-Exemption needs, scalability capacity and potential connection to Baumgarten.

He did note though that "The physical scope of the project is a pipeline system transporting and distributing 10 BCMA of gas from Turkish-Bulgarian border to Romania, Bulgaria and Hungary" adding that "SEEP technical team is working in close cooperation with Bulgartransgaz, the national transmission system operator (TSO) of Bulgaria, to assess the options for transit through the territory of Bulgaria using existing and/or new build infrastructure. A new build pipeline will be required through the territory of Romania". Mr. Odone's answer illustrates that BP is considering the utilization of the IGB and ITG pipelines which are crossing Greece as the BP spokesman confirmed that SEEP "is in contact with Greek entities" he chose not to specify.

In a question related to the potential extension of SEEP to Baumgarten, Mr. Odone replied that SEEP is still assessing with FGSZ "the capability to deliver gas to other Central and South East European countries utilising existing infrastructure". According to Mr. Odone the "The total length of a new build pipeline may be approximately 800 km". When it came to the potential price tag of SEEP Mr. Odone said that "the project costs will be refined after concluding the engineering appraisal studies". A very significant component of the project's final cost and its eventual competitiveness relates to its scalability, namely its technical ability to transport an additional 10 bcm/y of post SD2 Azeri gas that could be available by the early 2020s. Mr. Odone noted that for SEEP "The optimal upper limit of scalable will be identified through Appraisal studies in 2012". Another cost related issue is the potential level of TAP-Exemptions SEEP would need to secure, to which Mr. Odone replied that "throughout 2012, SEEP will progress different regulatory solutions and TPA Exemptions process with support from the national regulatory authorities and TSOs".

The second and less important parameter relates to the EC's continued efforts to break the Turkmen-Azeri deadlock over the construction of a Trans Caspian Gas Pipeline (TCGP) in the absence of a political agreement on the delimitation of their respective territorial waters and the concomitant sovereignty of the Kyapaz/Serdar field. On 29 February Natiq Aliyev appeared surprisingly upbeat on the prospects of a TCGP noting during a meeting of the Caspian-European Integration Business Club (CEIBC) that "Azerbaijan, Turkmenistan and the European Union are preparing a political document to support the Southern Gas Corridor, as well as an inter-governmental agreement on Trans-Caspian gas pipeline" Aliyev noted, adding that "This should take place before the end of the year", *Trend* quoted him as saying.

On 28 February, Gurbanguly Berdimukhamedov, Turkmenistan's President, repeated during an official visit to Turkey, his first foreign visit after his re-election on 12 February 2012, that Turkmenistan was ready to commit up to 40 bcm/y to a TCP option, "10 of which can be provided by Malaysian Petronas operating on the offshore block of Turkmenistan", while "the rest of the volume can be provided by 1,000-kilometer long East-West gas pipeline, which is under construction in the country's territory and originates from the Galkynysh field" *Trend* quoted him as saying. In any case though, a concrete agreement on the TCGP remains highly unlikely to occur within the decision timeframe of the Shah Deniz 2 consortium.

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