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Nabucco Signs Equity and Funding Agreements with Shah Deniz despite RWE's Withdrawal as TAP Partners May Consider Change of Route

by Theodore Tsakiris

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On 10 January 20103 the shareholders of the Nabucco International Company signed, after months of negotiations, two non-binding MoU that would formally put the Nabucco West pipeline on an equal footing with the Trans Adriatic Pipeline, the other alternative project for the transportation of 10 bcm/y of Azeri gas to Europe. The agreement calls on the four Shah Deniz (SD) partners, SOCAR, Total, Statoil and BP to join the five Nabucco participants, Turkey's Botas, Bulgaria's BEH, Romania's Transgaz, Hungary's FGSZ and Austria's OMV in the financing of the pipeline project's development costs until 30 June 2013. June 30th of this year is the declared deadline for the SD partners to reach their final decision on the main export pipeline between Nabucco and TAP. In addition to the co-financing of the development costs for a period that cannot be extended by more than 5 ½ months, the Nabucco partners will offer to the four SD companies equity options of up to 50% of the consortium's shares. This option would of course be exercised only if Nabucco is indeed selected.

RWE Abandons Ship

Although the agreement does not have a major practical impact on the relative power of the two competing consortia, it is certainly welcoming news for the remaining Nabucco partners which saw their most powerful shareholder, Germany's RWE, exiting the project on 3 December 2012. Germany's largest electricity producer announced its decision to sell its shares in Nabucco after almost a decade of lobbying and participation in a consortium that may still constitute the European Commission's favorite pipeline for linking EU markets with Caspian gas resources. A press release issued that same day merely noted that RWE's "main interest in Nabucco was to bring additional long-term gas transit streams to Germany" adding that the project no longer served this purpose because major gas supplies "could no longer be guaranteed".

RWE originally toyed with the idea of dropping the Nabucco project in July 2011 when it signed a MoU with Gazprom regarding the supply of Russian gas in exchange for the joint construction of new gas-fired power plants in the Benelux states. RWE was severely hit by Germany's decision following the March 2011 Fukushima accident to phase out its entire nuclear power basis by 2022 and shut down 8 nuclear power plants within 2011. As it came up against a short-term cash flow shortage, the company decided to cut down its exposure on projects of high cost and uncertain medium-term value.

In any case Nabucco would have made sense for RWE, the only major German company not yet dependent on Gazprom supplies (compared to EON Rhurgas and Wintershall), if it was a 30 bcm/y project as it were originally conceived. That is why RWE expended its presence in the upstream sectors of both Azerbaijan and Turkmenistan and that is why it systematically pushed to control at least 1/3 of the pipeline's capacity. When this original concept collapsed in 2012 leading to the replacement of Nabucco's Turkish branch by TANAP, the Germans lost a great deal of their interest in a pipeline whose real final cost varied between $12-15 billion.

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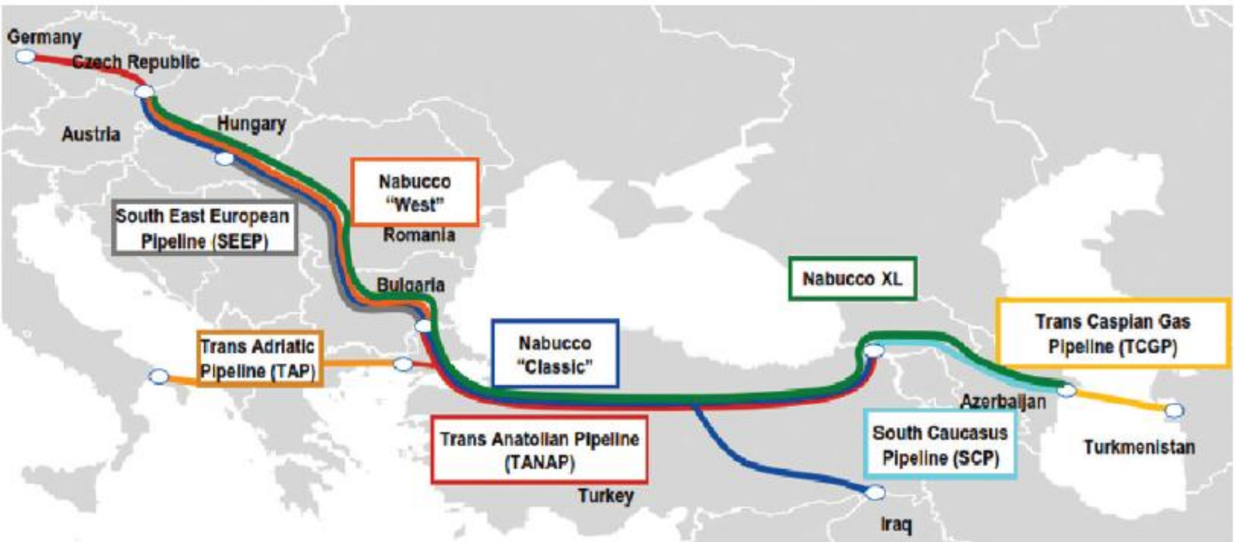

Source: RWE

In reality RWE was signaling its change of heart even *before TANAP's emergence.* On 17 January 2012, Juergen Grossmann, RWE's CEO at the time stated that "The important thing is that Caspian gas flows to Europe and that it arrives in the quantities we need and where we need it" adding that "Whether the pipeline is called Nabucco or Turandot [respectively Verdi and Puccini operas] doesn't really matter to us". The important thing for RWE was to "keep our own financial exposure limited." **The fact that RWE decided to withdraw from the project although Nabucco had diminished –due to the emergence of the TANAP pipeline- its original capex costs by more than 70% is indicative of Nabucco's deepening dead-end**. On 13 May 2012, two months before Grossman was succeeded by Peter Terium as CEO, he publicly acknowledged that RWE was "reviewing whether our commercial and strategic goals regarding Nabucco continue to be preserved". After Hungary's MOL decided on 25 September 2012 to freeze its quarterly contributions to the consortium's budget, RWE appears to have crossed the point of no return.

On 7 December 2012, OMV's CEO Gerhard Roiss told a press conference in Vienna that he understood RWE's rationale, noting that OMV would have done the same had it not found in a joint venture with ExxonMobil a major potential discovery in the Romanian sector of the Black Sea in February 2012. Although the field's commerciality will not be confirmed before 2014/2015, OMV's boss appeared adamant that RWE's withdrawal will not adversely influence Nabucco's chances vis-à-vis the Trans Adriatic Pipeline. "It is not an issue of control, it's an issue of investment. The shareholders of Nabucco at the end will be the ones who have the gas" Roiss said adding that "OMV is not going to force any prestige projects". He also confirmed that his company was in talks with RWE about the purchasing of its 17.6% stake a process that was recently completed.

The Real Impact: TAP and SOCAR's interest in DESFA

As already mentioned, the Equity Option & Funding Agreements Nabucco signed with the Shah Deniz partners do not

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alter the balance of power between the two competing consortia. TAP had already signed the same agreements with SD in June 2012 and it was only a matter of time before SD signed the same non-binding MoU with Nabucco. What is important to note though is that since June 2012 BP, Total and SOCAR have been drawing closer to the Trans Adriatic Pipeline option; an option led by their own Shah Deniz partner, Statoil. In particular SOCAR and its partners appear to be convinced of TAP's superior commercial and technical advantages but are also genuinely concerned about the political frictions between Albania and Greece over a series of issues and most importantly the pending ratification of a 2009 agreement on the delimitation of their respective Exclusive Economic Zones (EEZ). Albania's Supreme Court cancelled the agreement in 2010 after the country's opposition appealed the decision of the government to submit the 2009 agreement for ratification by Albanian Parliament.

Despite a recent row in Greek-Albanian diplomatic relations over some irrational irredentist statements made by Albania's President Sali Berisha in November 2012, Greece has started the Host Government Agreement (HOA) talks with TAP on 19 December 2012 signaling its willingness to promote the €1.5 billion pipeline. On 18 January 2013 TAP initialed the HOA with Albania in yet another indication that the project is gaining momentum. Azeri interest in TAP is also indirectly illustrated by SOCAR's participation in the privatization tender for the Greek Transmission System Operator (TSO), DESFA.

The Greek state is offering 69% of its shares in the former DEPA subsidiary and is expected to take its final decision before June 2013. Russia's Negusneft and Azerbaijan's SOCAR are considered to be two of the leading bidders for the TSO's tender.Apart from the obvious commercial merit of such a decision, Baku wants to be certain that it will not throw its weight behind TAP only to find that the implementation of the project is dependent on a Russian controlled DESFA, even if it is not a Gazprom controlled DESFA.

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Russia's Negusneft is perceived as the highest bidder in DESFA's privatization, offering as much as €900 million for the company's assets that include a critical component of the national gas grid connecting the Greek-Turkish border with the city of Komotini where TAP is currently planned to begin. TAP's shareholders may be seriously considering the extension of the pipeline's route from Komotini to the Greek/Turkish border so as to completely bypass the state owned national pipeline network. Although it is not clear how much that extension would cost, TAP may feel obliged to reach the Greek-Turkish border as an independent pipeline system in order to assuage SOCAR's fears. In that case SOCAR may be more likely to withdraw its interest in the privatization of DESFA but is also more likely to decisively support TAP and lead Shah Deniz towards its final decision even before its official June 2013 deadline.

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