Reasons to be cheerful: Nabucco

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Nabucco – one of four pipeline projects that aim to open up the so-called Southern Corridor by linking European gas markets directly to the significant reserves of the Caspian and Middle East regions – has its obvious merits and demerits, but it is the off-the-record comments of its observers that reveal the balance between the two

Delegates at a conference at Chatham House in London, organized by the Conservative Friends of Turkey and the European Azerbaijan Society January 27, on Azerbaijan and Turkey's importance to energy security tried to relax in the knowledge that Chatham House Rules allow comments to be published but forbid the use of the names of participants and the organizations they represent.

It was a given among delegates that the Southern Corridor is the only option available to Europe to create diversified supply routes and sources, and the argument that Nabucco is the only project that can secure these benefits seemed at least to be louder than the cases for the competing South Stream, IGI or TAP projects.

The six shareholders in the Nabucco consortium are Turkey's Botas, Bulgaria's Bulgargaz, Hungary's MOL, Austria's OMV, Germany's RWE and Romania's Transgaz.

"South Stream is promoted to by-pass Turkey and to maintain control in the producer countries. Italian projects are small and dedicated to Italian markets, which are over-supplied, and require significant short-term investment in the Botas gas grid. If successful they will close European access to Caspian gas other than quite small amounts from Azerbaijan for years," a delegate said. Nabucco is the project that will fully establish Turkey's role as an energy hub: with 31 Bcm a year it will pull gas from the Caspian region and the Middle East into Turkey and on to Europe."

"At €77/1,000 cu m, Nabucco will incur by far the lowest wellhead-to-market cost of the four projects (see table). Nabucco offers shippers and Caspian gas producers the most competitive transport costs and optimal value. The distance-related tariff of Nabucco is 41% to 73% cheaper than the competing projects and the wellhead-to-market cost of Nabucco is 15% to 22% cheaper," he added.

The fact Nabucco wouldn't just go east-west but west-east too was a repeated point, since Nabucco should be able to allow gas traders to transport gas anywhere between Austria and the Turkish-Georgian border. "It will cause a good deal of constructive disruption; there will be real competition, whereas at the moment with long-term gas supply contracts the market is quite tightly closed," a conference participant said.

Sourcing the gas

The original idea when the €10 billion Nabucco project was first mooted a decade ago was that its owners would be taking gas from Iran. There are two reasons why, for the moment, this will not be the case. Firstly, Iran is a net importer of gas and, secondly, the political situation – both internally and externally – makes it difficult for them to get anywhere near Iranian gas.

Where then are Nabucco's owners going to get the gas from? They have had "very intense talks" with their colleagues in SOCAR and the authorities in Azerbaijan, a delegate said, and they are "very keen indeed" for an agreement to come to pass.

"They need to demonstrate to SOCAR and the Azerbaijani government that they can offer the most attractive netback prices for the gas and the best secure routes for supply," a delegate said. "They have also had a lot of discussions with Turkmenistan and they hope to be able to sign a Heads of Agreement in March/April for the delivery of 10 Bcm/yr of gas," he added.

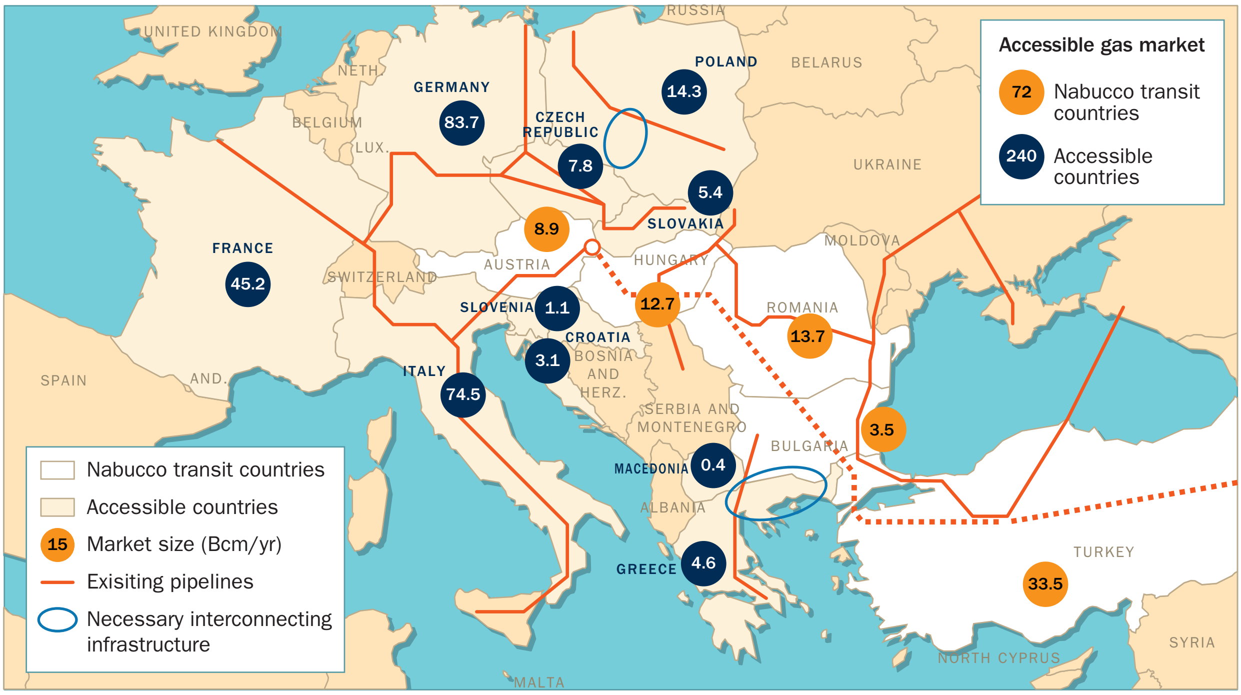
The third area is Northern Iraq. OMV and MOL have invested in gas fields in that area and Nabucco owners imagine they could get 30 Bcm/yr of gas, which would be enough to fill the whole pipeline, but more than they would need for Europe. For that, the authorities in the northern Iraq would have to agree with the authorities in Baghdad as to the arrangement for the export of gas. Nabucco's partners are also looking to see how they can help with the distribution of gas within Iraq.

How do they get gas from Turkmenistan to Azerbaijan? There are four ways of doing that, the conference heard. One is through Iran with the renewal/upgrading of existing pipelines through that country to the Turkish border. This would be the cheapest option but the current political situation makes it impossible, a delegate said.

They could have LNG or CNG tankers going between the Turkmen and the Azeri coastlines. That would be quite complicated and expensive, but would be the "second-best" option commercially.

The ideal situation would be to build a large capacity trans-Caspian pipeline and some delegates said they imagined that in the long term that may well happen. But in the short term there is the question of the status of the Caspian Sea, and at the moment it would in principle require the agreement of all countries neighboring that body of water.

Nabucco accesses 310 Bcm/yr European markets



Source: Not disclosed (Chatham House rules)

The trans-Caspian pipeline is a more than 300-km submarine pipeline from Turkmenistan to Azerbaijan. It will connect Turkmen offshore facilities with those in the Azeri sector using existing links to the shore. It is technically and commercially feasible to carry small amounts of 10 Bcm/yr, a conference participant said.

The final way is that there are two offshore fields, one on the Azeri side, and one on the Turkmen side, which Nabucco should be able to connect with about 60 km of pipeline. Its owners reckon they could build that in about 18 months and simply pump the gas in between those two fields. This offshore technical tie-in solution offers the greatest scope, a delegate said, because they are common in the region – for example, Azerbaijan has more than 2,000 km – and such tie-ins would largely avoid the unresolved questions of maritime law in the Caspian.

There are competitors for this gas of course, but the pro-Nabucco side says that of all the pipelines mooted at the moment, Nabucco is the only one that can provide substantial connection between Europe and the Caspian.

They believe it will also help Turkey “very considerably” in solving some of the problems it has had. These problems include recently large fluctuations in demand and the fact that “Botas in particular” has had to pay off quite a lot of take-or-pay gas contracts. Nabucco would allow Turkey to even out its supply and demand patterns. “It will have a reverse-flow function which will allow you to pump gas to wherever it is needed,” a delegate said.

The big idea

Construction of the 56-inch, 3,300-km Nabucco pipeline is expected to begin in 2011 and operations to start in 2014. Its capacity is to be increased in three phases: 8 Bcm/yr in 2014, 15.7 Bcm/yr in 2015/16 and, depending on demand, 25.5-31 Bcm in 2019/2020.

“Nabucco will be able to transport up to 31 Bcm of gas to Europe. It is commercially viable because there is large EU demand. That has gone down recently because of the economic slump, but the International Energy Agency suggests that by 2013 we will be back at the level of 516 Bcm/yr of demand in Europe, which is the level of just over two years ago,” a delegate said.

Conference speakers said they believe – and the IEA endorses this – that 680 Bcm looks very likely for gas consumption in 2030. The nuclear and renewable energy lobbyists were silenced before they could utter a word by the argument that “when the CO2 price goes up again” a lot of Europe’s coal-fired power stations will switch from lignite to gas. At the same time the North Sea and some other regions are rapidly depleted. A Nabucco devotee said: “We reckon that by 2030 there will be a production gap of 150 Bcm/yr, which we will not be able to fill by existing imports or domestic production.”

In addition, delegates heard, Europe is sitting near one of the greatest areas of gas reserves and production in the world. “People think of Azerbaijan and Turkmenistan as a long way away, but of Russia as on our doorstep. We are actually closer in the Caspian market to Europe than the fields from which Russia sources its gas for Europe. Nabucco's side believes it can offer gas to markets with about 310 Bcm/yr of demand (see map) in Europe. A lot of those are reliant entirely or very substantially on gas from Russia. Bulgaria, for example, has 100% reliance on Russian gas," one said.

"There is enough gas for Nabucco and it is available," a delegate said. In 2014-2016 there will be 'free' gas export capacity of more than 31 Bcm/yr from Azerbaijan, Turkmenistan and Northern Iraq. Azerbaijan will have more than 12 Bcm/yr of gas for export by 2014-2015 from its Shah-Deniz II development. Turkmenistan will be able to supply 10 Bcm/yr of export gas to Europe by 2015-2016. Northern Iraq will have a production potential of more than 30 Bcm/yr by 2014-2015, with an export potential of up to 15 Bcm/yr. "The technology is there to give access to the vast gas resources of Turkmenistan," the delegate added.

The paperwork

The Inter-Governmental Agreement was signed in July 2009, with ratification promised by all Nabucco transit countries by January 2010. Negotiations on the Project Support Agreements between the Nabucco consortium and each of the five transit governments are underway and aim to be completed in the first quarter of 2010. EU Exemption decisions have been issued in Bulgaria, Romania, Hungary and Austria, and clarifications are needed on Hungarian/Romanian decisions, which are to be finalized in early 2010.

The technical FEED (front-end engineering design) was launched in 2009 to define the pipeline route and to start the Environmental and Social Impact Analysis. By the end of 2009 the pipeline corridor and the final project definition – for example, which feeder pipes are to be included – were determined. The key critical path items are the ESIA and rights of way, a delegate said. "They will be ready in the next six months to go to the procurement of compressors," he added. On procurement, the development of a strategy to define the timetable for the purchase of Long Lead Items is underway and supplier negotiations are to start within eight months.

The European Investment Bank and the European Bank for Reconstruction and Development are "strongly supportive" in taking forward the financial arrangements and a declaration of intent to invest (with preconditions) is now underway in both banks. The European Commission has earmarked €200 million in 2010 for preparatory work under the European Energy Program for Recovery (EEPR).

Transportation agreements and tariff determination are under development with a target of the end of the first quarter of 2010. Open Season is expected in Q3.

Political support for Nabucco is growing: Nabucco is a European priority under TENs (Trans-European Networks); former EU Commissioner Andris Piebalgs and the President of the EU Commission, Jose Manuel Barroso, are strong public supporters; the German coalition agreement speaks of Nabucco and diversification as important for Germany and the EU to reduce undesirable one-sided dependencies on natural gas; there was a positive statement by French President Nicholas Sarkozy and Turkish President Abdullah Gul in Paris in October 2009, indicating their interest in participating in Nabucco; Turkish Prime Minister Erdogan raised the importance of Nabucco as the priority Southern Corridor project in a visit to President Barack Obama in Washington in December 2009; the US government is supportive of the project, seeing its importance for Turkey and the EU for diversifying gas supplies, and bringing Turkey and the Caspian countries together, and through this, for strengthening links to Europe and the West.

Good and bad vibes

Delegates enjoyed a 'reasons to be optimistic and pessimistic' debate about Nabucco that had the tidy result of three points on each side.

The first reason to be pessimistic is that in Europe there is a tendency of dismissing Nabucco now as an "empty piece of infrastructure", as "a merchant pipeline that's never going to happen", as "a pipe dream". The companies involved "don't have the cash", "they can't secure gas that is necessary to fill it".

But one country that is taking Nabucco extremely seriously it seems is Russia, one delegate noted. "Russia is pushing left, right and center to get South Stream built. It's signing a political agreement a month with potential transit countries for South Steam. It's picking up the Nabucco consortium members one by one and it's trying to buy up all the gas that might potentially be available for Nabucco. That doesn't make an awful lot of commercial sense, given that Russian gas production is stagnating; they are already building Nord Stream and they still seem to be having an eye on keeping the Ukraine corridor going. They recently signed another big take-or-pay contract with Slovakia, which means they are still relying on the Ukraine corridor to be in action. But they seem to think Nabucco actually really matters because it could disrupt the transit monopoly that is not only very lucrative for Gazprom but also politically useful as well."

The second reason to be glum is that the Nabucco project has become highly politicized. "I gather that the relationship between Azerbaijan and Turkmenistan is not as good as it used to be. There are now very clear signs they are negotiating, but the difficulty that they have right now in reaching agreement on gas supplies is at least partly related to political relations that have become somewhat sour," a delegate said. "Of course this has something to do with Turkey trying to make up with Armenia. Azerbaijan says you shouldn't do that until the Nagorno-Karabakh conflict is resolved. There's a whole strategic gamble all of a sudden that surrounds gas shipment from Azerbaijan to Turkey. Turkey is sitting pretty with its current gas agreement with Shah-Deniz I and Azerbaijan is perhaps rightly saying that that's not sustainable; if you want to have more gas you have to pay better prices for it and not just for the new gas."

Another reason that Nabucco has become politicized is that Turkey is negotiating for EU accession. "You would have thought that that would make it easier for the EU and Turkey to reach an agreement on energy cooperation," a delegate said. "In fact, it's making it more difficult. Wherever the EU has strong mutual interests, processes sometimes get blocked because the accession process is blocked. All the other Nabucco members are EU members, they have the EU acquis on energy, but Turkey doesn't have that.

On the Energy Community Treaty, under which the Balkan countries are taking over the EU energy acquis, Turkey quite rightly says, 'Well, if you want to talk to us about energy acquis, then open the energy chapter'. The EU says, 'We can't do that because Cyprus is blocking us'. As a result, the EU's energy cooperation with Turkey is actually slower than it would be if it wasn't negotiating for EU accession. That's a paradox."

The third reason that delegates were not optimistic is that the EU's relations with the potential supplier countries for Nabucco "are not great". "We haven't had a Central Asia policy so far. We have the beginnings of it now. We have a difficult relationship with Iran and we are not a big player in Iraq. We have the Eastern Partnership now, which involves Azerbaijan, but it's a relatively new initiative. I don't know if it has brought any concrete results, but surprisingly the Swedish presidency hasn't pushed very hard for it even though it was behind the inception of the Eastern Partnership," a delegate said.

The optimists found three counter-arguments. Firstly, "for better or worse" Nabucco is the flagship project for EU energy policy. "European energy policy is a very recent development. It was part of the single market policy: 'We liberalize the market and energy is just a market like any other'. It's only really in the last five years that we've actually thought of energy as a special sort of market. We had one objective for energy policy – to liberalize and get prices down for consumers in a functioning single market. Then they tagged on a second one which was climate change even though market liberalization doesn't necessarily contribute to a climate change objective. Then we had the third objective, which is energy security," a delegate said.

"That is relatively recent," another added. "There are still so many people in the EU who think that energy market liberalization automatically contributes to the other objectives. They do in some sense but maybe in another sense they don't; they are still trying to work out how these all hang together. We've never had external energy diplomacy which is something the EU is looking at now. It's very hard but at least it is making a start."

The second reason to be cheerful is that the EU is trying to push for a Caspian development corporation that "aggregates European gas contracts and through which it hopes it might get Turkmenistan interested in selling us gas," a conference participant said. "We are trying to mimic the much more muscular foreign policy that China, Russia, and even the US offer."

The third reason to be optimistic about Nabucco was somehow lost in a gloomy debate on diplomacy. "It's very complicated to have EU energy diplomacy because EU

Southern Corridor gas pipeline projects

Projects	Capacity (Bcm/yr)	Pipeline length	Capex (€ billion)	Start-up	Project owner	Distance-related tariff **	Wellhead-to-market cost***
Nabucco	25.5-31.0	3,300 km (+ 690 km) * 3,990 km	8	2014	RWE/OMV/MOL/BOTAS/ BEH/Transgaz	1.7	77
South Stream	63	3,200 km (+ 1,300 km) * 4,500 km	25	2015	Gazprom/ENI	2.9	90
IGI	10	807 km (+ 2,690 km) * 3,497 km	1.1	2012	Edison/DESFA	6.2	104
TAP	10	520 km (+ 2,940 km) * 3,460 km	1.5	2012	EGL/Statoil	3.8	106

* Source: CERA, 2009 annual consumption figures; ** €/1,000 cu m/100 km; *** €/1,000 cu m

Source: Not disclosed (Chatham House rules) energy policy is so disjointed. Energy policy is something that DG-Tren used to do. The tasks related to other countries are with the EU foreign ministers sitting together, doing political deals. Then you had the DG for external relations. It was very disjointed," a delegate said. For a country like Turkmenistan it's confusing. Imagine this: the Chinese come in and say, 'We are your friend, we want to buy this much gas, and by the way here's some money for roads and hospitals'. Then you have people from Brussels turning up and saying, 'We can't really commit to anything'," a delegate said.

The positive note in all this is that the Lisbon Treaty – which streamlines the organizational structure of the EU's foreign policy – "has cleaned up foreign policy and may hopefully make a difference here because now we have a representative. As she [Margot Wallstrom] is the vice president of the European Commission, she might be able to talk about energy as well," the delegate added.

Another big obstacle the EU had towards having a more effective energy policy was Germany – "the key country when it comes to European energy", according to one speaker. "When you ask the Germans about energy policy, they say it is a matter for private companies; they don't want any government involvement, and they certainly don't want any EU involvement. I do see a certain re-think going on in Germany; they think it's great that a German company [RWE] is involved in Nabucco."

Another speaker added: "We are finally making progress on an internal energy market. We are building physical interconnectors, which is something German energy companies will have much more of an interest in. Having a supply disruption in one part of Europe all of a sudden becomes of interest to countries in other parts of Europe as well."

Always a bridesmaid

The 8 Bcm of gas for the first phase of Nabucco was always expected to come from Azerbaijan's Shah-Deniz II gas development. But Azerbaijan and Turkey can't agree on how much Azeri gas should go to Turkey, at what price and under what terms. While the dispute continues, the companies involved in Shah-Deniz II have stopped drilling.

Turkey buys around 6 Bcm of gas from the Shah-Deniz I field and sells half of that gas on to Greece at a much higher price than it pays for it. A revision of the pricing formula is needed before there is any hope of an agreement on Shah-Deniz II gas. It is this gas that Nabucco needs to get going.

The chance of a settlement to the Nagorno-Karabakh issue in the near future is slim to say the least, but both countries do have an interest in reaching a deal on energy.

A supporter of the Turkish side at the conference stressed that Turkey – which has again recently postponed ratifying Nabucco – was functioning as a transit country and was not presenting itself as a hub, about which some conference delegates seemed to be confused. "Turkey is just trying to be a well-functioning transit country," he said.

A genuinely surprised delegate replied: "Well, if that's the case, then Turkey's PR policy needs to be improved because there are lot of people in the European Union that are under the impression that Turkey not only wants to be a hub, but wants to keep maximum control over the gas that flows through the pipes on its territory. We know that situation very well – that's what Russia does," she said.

"The EU won't be as strongly motivated in its efforts to replace Russian gas with gas that goes through Turkey if it thinks it will be replacing one regime that says 'all the molecules on our territory are our molecules' with another regime that takes the same attitude, especially if one of these regimes happens to produce the molecules and the other doesn't," another added.

A Nabucco devotee offered "reassuring words". Turkey has a problem, he said, which is that it has fluctuating demand. "It has dreadful storage capacity, whereby it can't actually manage how much it has contracted to bring in and how much it actually uses, and at the moment the capacity is not there for them to act a major hub where you need transport and storage capacity. What we think will happen when the Nabucco pipeline is there, is that it will be able to pump in all directions and it will allow Turkey to balance much more easily its supply and demand."

Conference participants discussed the fact that the Nabucco pipeline has different legal frameworks and transit agreements for the existing gas to Turkey.

"The Inter-Governmental Agreement states that Turkey may not take any gas out of the pipeline, except that which it is contracted to buy itself, nor may it impose any tariff on the transport or transit of gas," one argued. "That said, 50% of capacity in Nabucco is available for third parties to buy, so if Turkey bought some of that capacity, and pumped the gas it had bought and sold it on, and the Nabucco pipe acted to divide the storage capacity by evening out supply and demand, then Turkey could take up the role of a hub, without damaging the interests either of supply countries or consumer countries," he added.

Then someone mentioned France and the fact "it doesn't like Turkey" and hadn't been "keen on GDF joining Nabucco". "RWE "didn't know that at the time and very gladly moved into the space left by them," another said, adding that investigations on adding a seventh shareholder in Nabucco from France are underway, with long-term potential benefits in the wider EU context for Turkey.