



# Energy and Politics: Behind the Scenes of the Nabucco-TAP Competition

Nicolò Sartori

## Abstract

The European Union launched the Southern Gas Corridor initiative with the twofold aim of strengthening the diversification of Europe's gas sources and transportation routes, and reducing the role of upstreamers in the European gas market. The clear preference expressed by the European Commission - the corridor's mastermind - for Nabucco was expected to weigh in heavily, allowing the EU-backed project to easily win the competition. However, other factors, beyond political support, ended up tilting the balance decisively in favour of Nabucco West's final rival, the Trans-Adriatic Pipeline (TAP). These do not include only the technical and commercial criteria set out by the Shah Deniz II consortium, but also more mundane considerations. Nabucco West's complex organizational and decision-making procedures, the attractiveness of the exemption from Third Party Access (TPA) granted by the EU to TAP, and SOCAR's specific interest in the Greek market also influenced the consortium's final decision. An analysis of the Southern Gas Corridor competition suggests that when it comes to energy, political support and institutional involvement do not always represent the decisive element, and may be counterproductive at times.

**Keywords:** *European Union / Energy supply / Natural gas / Pipelines / Azerbaijan*

## Energy and Politics: Behind the Scenes of the Nabucco-TAP Competition

by Nicolò Sartori\*

### Introduction

“Pipes are 90% politics and 10% steel,” claimed a representative of the Trans-Adriatic Pipeline (TAP) consortium two years ago, commenting on the status of the contest for the development of the Southern Gas Corridor.<sup>1</sup>

At that time, the statement sounded like an exorcism. In fact, the TAP project was clearly the underdog in the competition to deliver Shah Deniz II gas to Europe, insofar as it lacked political support from EU and member state institutions. The political favourite was without doubt the European Commission’s flagship project Nabucco, a strategic pipeline that would have brought Azerbaijani gas to those Central and Southeastern European countries considered over-dependent on Russian supplies. Besides Nabucco, the Edison-led Interconnector Turkey-Greece-Italy (ITGI) project - officially recognized as a project of European interest by the European Union - represented the Commission’s tactical option to deliver Caspian supplies to Europe through Greece and Italy.

When the TAP representative made his statement, nobody from the audience attempted to rebut the point on the close relationship between politics and pipelines. Most likely very few participants would have bet a cent on the possibility that two years later TAP would have eventually been chosen by the Shah Deniz II consortium as the pipeline to deliver gas to European markets. What explains the apparent U-turn?

### 1. European political support

The launch of the Southern Gas Corridor initiative by the European Union had a clear political rationale based on the need to strengthen the diversification of European gas sources and transportation routes, in order to ease dependence on Russia, particularly in Central and Southeastern Europe. At the same time, the development of the corridor was aimed at reducing the role of producing countries and upstream energy companies in the European gas market. From this perspective, Nabucco neatly dovetailed with Brussels’ policy priorities. The pipeline was in fact a fully European project, implemented by national mid-streamers, expected to bring new volumes of Caspian

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gas to markets that were heavily dependent on Gazprom's supplies, bypassing Russia's soil.

Brussels' unambiguous preference was summarized by President José Manuel Barroso's remarks during the ceremony for the signature of the Nabucco Intergovernmental Agreement (IGA) on 13 July 2009. Intervening in the name of the Commission, "which [...] facilitated the negotiations", he stressed that "Nabucco [would] provide energy security to Turkey, to South East Europe, and to Central Europe. Nabucco is thus a truly European project." He highlighted that "the European Commission is very proud of the contribution [it] made to this agreement."<sup>2</sup>

On the contrary, the 2013 TAP IGA was saluted neither by an institutional ceremony, nor by a special endorsement of President Barroso. EU Energy Commissioner Günther Oettinger, whose tones were definitely less sumptuous than Barroso's, pointed out that TAP "*could* [emphasis added] be among the first components of the Southern Gas Corridor which aims at linking directly the European Union with the rich gas sources in the Caspian Region."<sup>3</sup>

The clear preference expressed by EU officials contributed to create a mood of overconfidence amongst the Nabucco West shareholders, who - despite alarm bells such as RWE's withdrawal from the project or the need to widely review the pipeline's parameters - were sure that political support from Brussels would have tilted the scales in their favour, and would have allowed the project to win the competition. This was not the case. Other factors, beyond political support, ended up weighing heavily and tilting the balance decisively in favour of TAP.

## 2. Intervening factors

The Southern Corridor selection process was formally based on the eight criteria set out in February 2011 by the Shah Deniz II consortium.<sup>4</sup> Seven of them - namely *commerciality*, *project deliverability*, *financial deliverability*, *engineering design*, *alignment and transparency*, *safe and efficient operability*, and *scalability* - have clear technical, economic or commercial dimensions. Political aspects were relegated to the eighth selection criterion, *public policy considerations*, which covered Azerbaijan's strategic considerations, the EU's stated objective of enhancing the supply diversity in European natural gas markets, and the general interests of all stakeholders.

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<sup>2</sup> European Commission, *Remarks by Commission President José Manuel Barroso upon the signature of the Nabucco intergovernmental agreement* (SPEECH/09/339), Ankara, 13 July 2009, [http://europa.eu/rapid/press-release\\_SPEECH-09-339\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-09-339_en.htm).

<sup>3</sup> European Commission, *Commissioner Oettinger welcomes the signature of the intergovernmental agreement on TAP* (IP/13/112), Brussels, 13 February 2013, [http://europa.eu/rapid/press-release\\_IP-13-112\\_en.htm](http://europa.eu/rapid/press-release_IP-13-112_en.htm).

<sup>4</sup> Shah Deniz Consortium, *Principles for the selection of an export route to Europe for Shah Deniz gas*, February 2011, [http://www.bp.com/liveassets/bp\\_internet/bp\\_caspian/bp\\_caspian\\_en/STAGING/local\\_assets/downloads\\_pdfs/pq/Principles\\_for\\_selection\\_of\\_an\\_export\\_route\\_to\\_Europe\\_for\\_Shah\\_Deniz\\_gas.pdf](http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/pq/Principles_for_selection_of_an_export_route_to_Europe_for_Shah_Deniz_gas.pdf).

At the “European pipeline announcement event” held in Baku on 28 June 2013, Gordon Birrell - BP’s Regional President for Azerbaijan, Georgia and Turkey - summarily mentioned the eight parameters as the basis for the lengthy and comprehensive evaluation which led to the selection of the preferred project.<sup>5</sup> However, the Italian undersecretary responsible for energy Claudio De Vincenti clearly made reference only to the “first seven criteria” to explain the victory of TAP, minimizing the impact of political considerations on the final decision of the consortium.<sup>6</sup>

Commissioner Oettinger publicly stressed that the verdict was based on commercial considerations,<sup>7</sup> while BP - the operator of the Shah Deniz field - officially pointed out that there was a significant commercial difference between the two competing projects.<sup>8</sup> Commercial aspects - such as the cost of shipping Azeri gas, the expected prices and demand forecasts in the respective markets, as well as potential access to Western Balkans’ transmission systems - determined the consortium’s preference for TAP.

Beyond these commercial considerations, what emerges from unofficial discussions with Shah Deniz II consortium representatives is that other more mundane considerations also weighed in the consortium’s final decision. In particular, Nabucco West’s complex organizational and decision-making procedures were considered as having produced a commercial disadvantage compared to TAP, contributing to its failure. For instance, the negotiating methods of the Nabucco Committee - the coordinating structure of the public and private stakeholders involved in the development of the pipeline<sup>9</sup> - generated misunderstandings amongst some of the energy companies in the Shah Deniz II consortium. Suffice it to mention that despite its head start in terms of timeframe, having begun far earlier than TAP, the Nabucco consortium was only able to sign the Funding, Equity & Shareholding Agreement with the Shah Deniz II consortium in January 2013,<sup>10</sup> while the TAP agreement dates back to August 2012.<sup>11</sup>

From a legal perspective, the exemption from Third Party Access (TPA) granted by the EU to TAP appeared more attractive than the scheme agreed for Nabucco. TAP, in fact, would have been allowed to offer the Shah Deniz II consortium the pipeline’s entire initial export capacity (10 billion cubic meters, bcm) for a period of 25 years,

<sup>5</sup> Gordon Birrell, *Speech at the European pipeline announcement event*, Baku, 28 June 2013, [http://www.bp.com/liveassets/bp\\_internet/bp\\_caspian/bp\\_caspian\\_en/STAGING/local\\_assets/downloads\\_pdfs/0\\_999/2013.06.28-Gordon-Birrell-speech.pdf](http://www.bp.com/liveassets/bp_internet/bp_caspian/bp_caspian_en/STAGING/local_assets/downloads_pdfs/0_999/2013.06.28-Gordon-Birrell-speech.pdf).

<sup>6</sup> Alberto Sisto, “TAP outgunned Nabucco for Azeri gas on most fronts”, in *Reuters*, 1 July 2013, <http://uk.reuters.com/article/2013/07/01/italy-tap-ministry-idUKL5N0F722M20130701>.

<sup>7</sup> Cristian Pantazi, “Gunther Oettinger, on the failure of Nabucco West”, in *HotNews*, 1 July 2013, <http://m.hotnews.ro/stire/15104603>.

<sup>8</sup> S. Aliyev, “BP: TAP and Nabucco had big commercial difference”, in *Trend*, 28 June 2013, <http://en.trend.az/capital/energy/2165695.html>.

<sup>9</sup> The Nabucco Committee was composed of the five government signatories of the Nabucco IGA, the European Commission, the Nabucco Gas Pipeline International operational company, the European Investment Bank, the European Bank for Reconstruction and Development and the World Bank.

<sup>10</sup> Nabucco, *Joint declaration of Nabucco Shareholders, NIC, Potential Investors and Shah Deniz Consortium*, 10 January 2013, available at <http://www.bloomberg.com/article/2013-01-10/aaddhukjwE4c.html>.

<sup>11</sup> TAP, *Shah Deniz Partners BP, Socar and Total Commit to Funding for TAP*, 9 August 2012, <http://www.trans-adriatic-pipeline.com/it/news/news/dettaglio/article/330>.

while in the second phase the new volumes (a further 10 Bcm) would have been allocated through an Open Season process.<sup>12</sup> As for Nabucco West, in May 2013 the national regulators of Austria, Hungary, Romania and Bulgaria confirmed the 50% exemption from TPA, on both the initial capacity (for a total of 5 bcm) and the second phase (another 6.5 bcm), as had been granted to the Nabucco consortium years ago.<sup>13</sup> The access to the entire capacity in the initial phases of field production activities encouraged the Shah Deniz II shareholders to select TAP.

Last but not least, the commercial interests of SOCAR - the energy company controlled by the Azerbaijani government and a key member of the Shah Deniz Export Negotiation Team (ENT) - in the Greek gas market contributed to the preference for TAP. During the evaluation phase, SOCAR expressed its commercial interest in acquiring the Greek natural gas grid operator DESFA, and a few days before the Shah Deniz II decision, SOCAR reached an agreement with the Hellenic Republic Assets Development Fund (HRADF/TAIPED) for the acquisition of a 66% stake in the company.<sup>14</sup> For SOCAR, controlling DESFA meant entering the European gas transmission and distribution sector for the first time. Coupled with the selection of TAP, the acquisition of DESFA was strongly consistent not only with SOCAR's interest in strengthening its position in the Greek market, but also with its objective of expanding its export capacity to Greece's Balkan neighbors.

### 3. Winners and losers

The competition for Shah Deniz II gas, and in particular the evaluation of the final transportation offers, was long and intriguing, with a surprising outcome. Various actors, with different interests at stake - of political, economic, and commercial natures - were involved. While some may diplomatically argue that the result "is a victory of Europe,"<sup>15</sup> the truth of the matter is that the consortium's verdict entails both winners and losers in the Southern Corridor game.

One winner is certainly Azerbaijan. Thanks to clever tactical moves and good negotiating skills, Azerbaijan achieved its key strategic goals of diversifying its gas exports, establishing a closer relationship with the EU, and increasing its role on the whole gas supply value chain. The first, fundamental, move was the launch of the TANAP initiative, which allowed SOCAR to extend its control over midstream activities up to the Turkey-EU border.<sup>16</sup> Next, Azerbaijan reinforced its position with the signature, in August 2012, of the Funding, Equity & Shareholding agreement between the Shah Deniz II consortium and TAP. As a result of the deal, SOCAR today controls -

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<sup>12</sup> TAP, *Trans Adriatic Pipeline Secures Third Party Access Exemption*, 17 May 2013, <http://www.trans-adriatic-pipeline.com/it/news/news/dettaglio/article/404>.

<sup>13</sup> Nabucco, *National Regulators Confirm Prolongation of Nabucco Exemption*, 14 May 2013, available at <http://www.news.az/articles/79706>.

<sup>14</sup> SOCAR, *SOCAR purchases a major stake in Greece natural gas transmission system operator - DESFA S.A.*, 21 June 2013, <http://new.socar.az/socar/en/news-and-media/news-archives/news-archives/id/6221>.

<sup>15</sup> Alberto Sisto, "TAP outgunned Nabucco for Azeri gas on most fronts", cit.

<sup>16</sup> See the TANAP website: *TANAP Project, The Silk Road of Energy, Has Been Signed*, <http://www.tanap.com/en/the-energy-of-the-future-is-ready.aspx>.

along with the pipeline's initial shareholder and the other Shah Deniz II partners - a 20% stake in TAP.<sup>17</sup> The acquisition of DESFA referred to above completes the picture.

The other Shah Deniz II consortium shareholders can also be counted among winners. Thanks to the equity acquisition granted by the Funding, Equity & Shareholding agreement, they will control the flow of gas from production all the way down to the end consumer. In addition, having chosen TAP they will enjoy more favourable conditions in terms of the derogations from the EU TPA rule.

For the Italian, Greek and Albanian governments, the victory of TAP also represents a significant success. The southern route of the corridor had generally been presented to European publics as the second best option *vis-à-vis* Nabucco, and the Shah Deniz consortium's 2012 decision<sup>18</sup> to exclude the EU and government-backed ITGI project from the competition was seen as the definitive defeat of Italy and Greece's strategies for the corridor.<sup>19</sup> After initial hesitations, however, the Albanian, Greek and Italian governments made significant diplomatic efforts resulting, in few months, in the signature of the Memorandum of Understanding and the Trilateral Intergovernmental Agreement.<sup>20</sup> With its victory, TAP will help Italy to further diversify its gas imports, enhancing its ambition to become - as stated in its national energy strategy - a gas hub for Europe. Greece, while diversifying its imports - which today are heavily dependent on Russia's supplies - could aspire to become, through the Ionian Adriatic Pipeline, an important gas distribution hub for Southeastern Europe and the Western Balkans.

Even without directly taking part in the selection processes, Russia will also indirectly benefit from the Shah Deniz II consortium's decision. The TAP route does not compete with any Russian project, while Nabucco was expected to supply the same countries as those reached by the Gazprom-led South Stream pipeline. This situation allows Gazprom to keep its quasi-monopolistic position and to secure its profits in Southeastern European gas markets, without being challenged by the new supplies coming from the Caspian.

Moving to the losers, the Southeastern European countries (and their national energy companies) involved in the development of Nabucco are certainly those most seriously affected by the final decision. In order to reduce their overdependence on Gazprom's supplies and strengthen their energy security, the governments of Austria, Bulgaria, Hungary, and Romania invested heavily in the Nabucco project. However, the political and strategic advantage of Nabucco and its stakeholders, eventually proved to be a

<sup>17</sup> TAP's shareholding is now comprised of BP (20%), SOCAR (20%), Statoil (20%), Fluxys (16%), Total (10%), E.ON (9%) and Axpo (5%). See TAP, BP, SOCAR, Total and Fluxys join the TAP project, 30 July 2013, <http://www.trans-adriatic-pipeline.com/news/news/detail-view/article/419>.

<sup>18</sup> TAP, *Trans Adriatic Pipeline selected by Shah Deniz as the priority route to Italy*, 21 February 2012, <http://www.trans-adriatic-pipeline.com/it/news/news/dettaglio/article/221/>

<sup>19</sup> Kostis Geroupoulos, "TAP: Greece, Italy still risk losing it all", in *New Europe*, 4 March 2012, <http://www.neurope.eu/article/tap-greece-italy-still-risk-losing-it-all>. See also the Joint announcement of the Ministers of Energy of Italy and Greece concerning the recent press references on the progress of negotiations on the materialization of the Southern Corridor, Athens, 20 February 2012, <http://www.ypeka.gr/LinkClick.aspx?link=230&tabid=37&language=en-US>.

<sup>20</sup> TAP, *Greece, Italy and Albania Sign a Trilateral Intergovernmental Agreement, Demonstrating Their Full Support for TAP*, 13 February 2013, <http://www.trans-adriatic-pipeline.com/it/news/news/dettaglio/article/379>.

constraint when it came to business management. Despite general promises that new volumes of gas from Azerbaijani fields such as ACG Deep, Absheron, Umid and Shafag-Asiman will eventually be routed towards Austria in future,<sup>21</sup> the current situation clearly highlights that the failure to diversify their gas supplies seriously compromises these countries' ability to stand up to Russia.

As regards the European Union and the Commission, should one consider the EU's prime energy goal that of providing new volumes of natural gas to Europe through a new southern transit route, the decision of 28 June clearly represents a success for the Commission's external energy policy. However, if the focus moves from these general goals to the specific objectives pursued by the Commission over the last decade, then the final response represents a clear policy failure. In fact, none of the specific objectives of the Southern Corridor - easing European dependence on Russia in Central and Southeastern Europe, and reducing the role of energy producing countries and upstream companies in the European gas market - have been achieved so far. Caspian gas, in fact, will flow through Greece towards Italy, and will be transported by a pipeline 70% owned by energy companies involved in upstream activities. While recognizing that the Commission's push has been fundamental in ensuring that Azerbaijani gas will eventually flow westward, an analysis of the Shah Deniz II competition suggests that Brussels' political intrusiveness in business-oriented procedures can be not only inefficient, but possibly also counterproductive.

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<sup>21</sup> Lada Evgrashina, "Azeris say Austria could get future gas supplies", in *Reuters*, 28 June 2013, <http://www.reuters.com/article/2013/06/28/gas-pipeline-azerbaijan-idUSL5N0F40E720130628>.



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