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A DEAL AT LAST: A BRIGHT FUTURE FOR AZERBAIJANI GAS IN EUROPE?

Samuel Lussac

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The gas negotiations between Azerbaijan and Turkey finally seem to have come to an end. According to a statement made by the Turkish Energy Minister Tamer Yildiz on April 27, 2010, Ankara and Baku have agreed on the amount and the price for the sale of Azerbaijani gas to Turkey. Such a deal not only paves the way for further progress in gas pipeline projects between the Caspian and Europe, it also provides for a warming of Azerbaijani-Turkish relations after the tensions arising from the signature of the Turkish-Armenian Protocols in October 2009.

BACKGROUND: In March 2001, Ankara and the Shah Deniz consortium signed a purchase and sale contract for the delivery of 6.6 billion cubic meters (bcm) a year of Azerbaijani gas beginning in 2007. This gas comes from the Shah Deniz field, which is the most important gas field in Azerbaijan. It is operated technically by the London-based company BP and commercially by Norwegian Statoil. The other shareholders are Azerbaijan's SOCAR, Russia's Lukoil, Iran's NIGC, and the Paris-based Total.

The contract signed in March 2001 only dealt with the first phase of production at Shah Deniz. The gas price agreed was US\$ 123 per thousand cubic meters (tcm). There are two main explanations for this fairly low price. First, it was calculated on the basis of the price Russia then paid for Turkmen gas since in 2001, Azerbaijan and Turkmenistan were competing to supply the Turkish gas market and the price was the result of relatively short negotiations. The Shah Deniz shareholders were concerned over the Turkish law on the Natural Gas Market that was supposed to enter into force in spring 2001. According to this law, BOTAS would no longer be allowed to import foreign natural gas. The two main negotiators – BP and Statoil – were thus willing to find an agreement before this law was passed.

However, in order to make this low price more acceptable, it was agreed that it would be renegotiated one year after the start of gas deliveries to Turkey. In April 2008, BOTAS and SOCAR thus started to discuss a new price. But the Azerbaijanis insisted on negotiating a package deal rather than pricing alone. This package was composed of the Turkish purchasing price for the gas from both Shah Deniz Phase 1 and Shah Deniz Phase 2 and of the fee Ankara would pay Baku for the transit of Azerbaijani gas through Turkey. Such a mix of issues did not help moving forward in the negotiations. Until spring 2009, Turkish Energy Minister Hilmi Güler rejected discussions about any transit fee for Azerbaijani gas. He insisted that Turkey should buy all this gas and sell it to Europe, according to a price decided by Ankara. Such a deal was unacceptable for Baku and the negotiations reached a deadlock.

In May 2009, the replacement of Hilmi Güler by Tamer Yildiz was warmly welcomed in Azerbaijan. But at this time, another issue blocked the negotiations: the Turkish-Armenian rapprochement. In October 2009, Ankara and Yerevan signed two diplomatic protocols, indicating plans to reopen the borders between their two countries. Turkey's mere consideration of this issue was outrageous for Azerbaijan, as the border was closed in 1993 as an act of support to Baku in the Armenian-Azerbaijani conflict. The commercial gas negotiations between

BOTAS and SOCAR then became highly political and in December 2009, SOCAR rejected a Turkish proposal, which both BOTAS and the Shah Deniz shareholders found acceptable.

IMPLICATIONS: To accept any Turkish proposal, Baku was waiting for two important moves. First, it wanted to be sure Turkey would not open its border with Armenia. This was ensured after Turkish Prime Minister Erdogan several times asserted Turkey's commitment not to open this border before a withdrawal of Armenian troops from occupied territories in Azerbaijan. Second, Baku closely monitored the attitude of the U.S. administration, and especially whether President Obama would avoid using the word 'genocide' in his April 24 speech for the commemoration of massacres of Armenians in Turkey in 1915. As neither an opening of the Turkish-Armenian border, nor an official U.S. recognition of the 1915 massacres as genocide took place, an agreement could be found between BOTAS and SOCAR.

Such a deal was announced on April 27. On the one hand, BOTAS has agreed to pay around US\$ 360 per tcm of Azerbaijani gas, i.e. a price in accordance with European ones. On the other hand, SOCAR has accepted a lower transit fee than originally expected. This compromise demonstrates that both parties know the importance of Azerbaijani gas flows through Turkey to Europe. Despite the start of gas deliveries to Russia in January 2010, Baku was not willing to sell all its gas to Russia. It did not want to re-establish a dependency it had rid itself of with difficulty in the early 2000s. Sending gas from Georgia to Bulgaria and Romania was another option considered but SOCAR knew it would be commercially viable only for small volumes (around 2 bcm a year). Therefore the only credible option to sell gas to Europe is to go through Turkey. Meanwhile, Ankara was aware that if it wanted to ensure its position as a transit point for gas deliveries to Europe, it needed to achieve a deal with Baku. When accomplished, Turkey will establish a key position for itself European energy markets.

Indeed, Turkey is at the cornerstone of the European-backed Southern Corridor, composed of four gas pipeline projects: the Interconnection Turkey-Greece-Italy (ITGI), Nabucco, the Trans-Adriatic Pipeline (TAP) and White Stream. Only the latter does not cross Turkey. The three others start in Turkey and were anxiously waiting for a deal to be found between Baku and Ankara. At least legally, they are well advanced. For instance, intergovernmental agreements have been signed for ITGI and Nabucco. The only main question that remains to be addressed relates to the gas supplies for the pipelines. Without Azerbaijan, none of them would ever be viable. Once an agreement between Ankara and Baku would be signed, the shareholders in these projects would start negotiating with SOCAR to increase Azerbaijani gas supplies to Europe.

Politically speaking, this deal suggests Azerbaijan's increasingly prominent position of leadership in the South Caucasus. SOCAR is turning into a flagship oil and gas company not only in Georgia but also in Turkey and in the Eastern part of the European Union. In the recent gas discussions, SOCAR was representing the Shah Deniz consortium and is negotiating directly with BOTAS. Such a format was fairly new, especially compared to 2001 when SOCAR was only consulted in the gas discussions between BP, Statoil and BOTAS. Moreover, despite strong European and U.S. pressure, Azerbaijani president Aliyev has rejected to disconnect the Turkish-Armenian rapprochement and the Azerbaijani-Turkish gas negotiations. He has thus demonstrated the ability of Azerbaijan to resist international pressure.

CONCLUSIONS: After two years of tough negotiations, Azerbaijan and Turkey have finally found an agreement on the sale and transit of Azerbaijani gas to and through Turkey. This deal is a breakthrough in the implementation of the European-backed Southern Corridor project,

aiming at diversifying gas supplies to Europe. A legal framework will now exist for the delivery of Caspian gas to Europe.

In the meantime, this agreement highlights the warming of the relationship between Baku and Ankara. After the signature of the Turkish-Armenian Protocols last October, relations between the two countries deteriorated, raising new concerns about stability in the South Caucasus. While relations between the main negotiators of BOTAS and SOCAR remain poor, Prime Minister Erdogan and President Aliyev have made efforts to rebuild confidence between their two countries.

This agreement amounts to a win-win situation. Brussels would be satisfied with the final resolution of negotiations that have raised concerns about the feasibility of the Southern Corridor. Moreover, Azerbaijan and Turkey can assert their key positions within the project. The only losers in this game is Armenia, and in the very short term, the U.S. administration. Hopes for a Turkish-Armenian normalization now seem to be dying; but the responsibility for this failure also lays with the Armenian and Turkish leaders who failed to ratify the Protocols. Washington's sole focus on this issue to the detriment of other South Caucasian matters has damaged its credibility as an honest broker in the region, especially regarding energy.