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Changing pipelines, shifting strategies: Gas in south-eastern Europe, and the implications for Ukraine

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ABSTRACT

Plans for gas pipelines in south-eastern Europe have experienced great upheaval in recent years, the result of business competition as well as the ongoing stand-off between Europe and Russia. The projects' advances and reversals reflect shifting strategies: those of new suppliers to find clients, those of traditional suppliers to conserve their markets and avoid regulatory impediments, and those of both suppliers and clients to ensure greater reliability. For many, this means planning to bypass Ukraine.

Yet Europe a as a whole does not have a single, coherent strategy. Different European countries have divergent relations with Moscow, and their multiple approaches to energy security impede coherence, particularly when it comes to Ukraine. Even within the EU institutions, the messages sometimes appear contradictory, with political declarations deviating from the technical statements of the European Commission.

Ukraine's fate – whether or not it remains a transit country for gas to the EU – depends on multiple factors: its own internal reforms, its integration with the EU market, and the EU's continued support.

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1 The old bear and the young contenders

The Russian state-owned gas company Gazprom long provided most gas consumed in Europe. But the company's comfortable lead has recently been challenged.

For many years, the Russian state-owned gas company Gazprom provided most of the gas consumed in Europe. But the company's reliable European revenues have become less certain by changes in the last decade.

The reasons are multiple: energy efficiency has improved; the share of renewable energies has expanded; the technology surrounding liquefied natural gas (LNG) has improved sufficiently to bring the EU gas from sources not connected by pipelines. What is more, Gazprom's leading position in the market has been legally challenged by the European Commission, which recently released the results of an investigation of a potentially game-changing antitrust case[1].

The battle is particularly fierce in Europe's south-east, although its impact will be felt further afield ... including, significantly, in Ukraine.

However, the major challenge the company faces stems from the evolving 'landscape of pipelines' in south-eastern Europe. Gas-rich countries, including Algeria, Libya, Cyprus, Azerbaijan and Turkmenistan, are making an effort to access the European market – through pipelines, Gazprom's traditional method of delivery – and capture a significant market share.

This paper focuses on this contentious issue of gas in Europe's south-east. The conflict has important ramifications for Europe, for Gazprom and for Gazprom's challengers. But it also has consequences for another country, currently embroiled in fight, and important to the EU: Ukraine.

2 Ukraine and Gazprom: An old and prickly relationship

Inherited from the Soviet Union time, the gas pipeline network linking Russia to Europe for decades passed through Ukraine for most gas moving from Russia to the EU. In 2009, 80 % of this gas was still transiting via Ukraine while it was only around 50 % in 2014. In exchange for transiting Ukrainian territory, Gazprom agreed to give Ukraine heavy discounts on gas.

Gas crises in 2006 and 2009 troubled the relationship and illustrated the problems that transit countries may cause the final clients. In 2006, while pro-European political forces were governing Ukraine (after the 2005 Orange revolution), Russia eliminated Ukraine's significant discount on gas[2]. After negotiations between the two broke down, the gas flow to Europe decreased substantially – either because Russia reduced exports[3] and/or because Ukraine disrupted the gas destined for Europe[4].

[1] See section 4.4.
[2] See In Ukraine-Russia Gas Dispute, Kiev Runs Out of Leverage, World politics review, 4 October 2011.
[3] See Ukraine gas row hits EU supplies, BBC News, 1 January 2006.
[4] See Ukraine 'stealing Europe's gas', BBC News, 2 January 2006.

The gas dispute between Russia and Ukraine continued until 2009, when Russia simply cut all gas flows to Ukraine. In addition to a shortfall in Ukraine, this resulted in a complete lack of supply in Bosnia and Herzegovina, Bulgaria, the former Yugoslav Republic of Macedonia, Moldova, and Serbia – and a shortfall of more than half in Austria and Czech Republic[5].

Europe's dependence on Ukraine for its gas was suddenly apparent – as was Russia's difficult position vis-à-vis its main transit route.

Searching for an alternative for Ukraine, and in addition to the under-construction Nord Stream pipeline - linking Germany to Russia via the Baltic Sea (See *Map 1*)[6] -, Gazprom announced in 2007 that it would build a new pipeline in the Black Sea. The new 'South Stream' project would link Russia directly to the EU and would bypass Ukraine (*See Map 1*).

The project might appear also to solve a problem for Europe: the unreliability of the gas supply transiting through Ukraine. In fact, however, South Stream became a point of disagreement, and was considered contradict the newly defined European energy strategy.

Map 1:
The South Stream project, Nabucco project and Nord Stream

Source: Natural Gas Europe[7]

[5] See The Impact of the Russia–Ukraine Gas Crisis in South Eastern Europe, Aleksandar Kovacevic, Oxford Institute for Energy Studies, March 2009.
[6] Nord Stream became operational in 2012.
[7] See Oettinger Denies Pipeline Rivalry, Natural Gas Europe, 10 February 2011.

3 Europe's energy security strategy

Europe has worked to lessen its energy dependency and diversify its sources.

For about a decade, energy has become increasingly central to the EU's agenda.

The Union has worked actively to increase the diversity of its energy mix in terms of types of energy, transit routes and geographic sources.

3.1 The rise of the Nabucco project

The Southern Corridor became a priority after the 2006 gas crisis.

Following the 2006 gas crisis that pitted Russia against Ukraine[8], the European Commission adopted the 'Second strategic energy review – An EU energy security and solidarity action plan' in 2008. The text made plain the Commission's desire to diversify sources of gas through a 'southern corridor'[9].

The Nabucco project was defined as a priority for completing the Southern Corridor.

This strategy encouraged EU Member States to propose projects for a 'new silk road'. The Nabucco project – started in 2002 and designed to bring Europe natural gas from the South Caucasus, Turkmenistan and possibly Iran – emerged officially as a priority[10].

The Nabucco project was a 3 800-km pipeline connecting Central Asia to Central Europe via Turkey and Southern Europe (*see Map 1*). The consortium in charge of the Nabucco was composed of six companies holding equal shares: BOTAS (Turkey), Bulgarian Energy Holding (Bulgaria), Transgaz (Romania), MOL (Hungary), OMV (Austria) and RWE (Germany)[11].

The project received strong political support.

The project immediately received strong political support from the EU, the United States, potential transit countries and energy suppliers experiencing difficulties in exporting their gas.

3.2 Nabucco's evolution into TAP and TANAP

Several factors nevertheless brought down the project.

Despite undisputable political support, the Nabucco project was officially abandoned in 2013. A number of factors led to the project's demise: EU clients' limited demands for gas, the high price of construction and competition from rival projects.

Nabucco would have competed with Russia's South Stream along its entire length.

Nabucco had always competed with the Russian South Stream project, which overlapped Nabucco's entire length. In addition, Nabucco was competing with two other projects:

- the Azeri-led Trans-Anatolia Pipeline (TANAP), which

[8] See Section 5.1.
[9] See COM(2008) 781 final, European Commission, 2008
[10] See The Southern Gas Corridor and the EU Gas Security of Supply: What's Next?, Natural Gas Europe, 28 March 2015.
[11] See Nabucco: A pioneering pipeline project, Reinhard Mitschek, December 2011

overlapped with Nabucco's eastern section, and

- the Trans-Adriatic Pipeline (TAP), which overlapped with Nabucco's western section[12].

The pipeline also vied with the Azeri-led Trans-Anatolia Pipeline (TANAP) in the east…

In late 2011, Turkey and Azerbaijan announced jointly that TANAP would be created to carry natural gas from the Caspian Sea Shah Deniz fields to Greece via Turkey. This project, serving fewer countries than Nabucco, was expected to be less costly than its competitor (EUR 5 billion versus EUR 8 billion) and was therefore favoured by the Azeri gas company[13].

Construction on TANAP started on 17 February 2015 with the inauguration of the Turkish segment in the region of Kars (in the east of Turkey). TANAP is expected to be completed by 2020 and will initially carry 16 billion cubic meters (bcm) of gas per year. Its capacity is expected to increase to as much as 31 bcm per year by 2026[14].

As a result, the once-ambitious Nabucco project was scaled back, becoming the 'Nabucco-West' project, projected to be supplied by TANAP and connecting the Greek-Turkish border to Austria. Even in its smaller incarnation, the Nabucco project remained in direct competition with the northern part of the South Stream project, financed by Gazprom.

… and with the Trans-Adriatic Pipeline (TAP) in the west.

Moreover, another competitor to Nabucco-West also emerged: the Trans-Adriatic Pipeline project (TAP)[15], conceived in 2003. The TAP consortium expressed the intention to connect to TANAP in order to link Turkey with Italy through Greece and Albania (*See Map 2*).

In 2013, having chosen a route that was 500 km shorter than that of Nabucco-West, TAP was chosen by the consortium Shah Deniz II as the only pipeline that would transport TANAP gas from the Turkish-Greek border to Europe.

As a result, the Nabucco project was officially cancelled later that year, and the TANAP/TAP project became the new 'Southern Gas Corridor'[16].

[12] See Farewell to 'greater' Nabucco as TANAP emerges to replace it, Today's Zayman, 17 March 2012.
[13] See The Nabucco Pipeline Project: Gas Bridge To Europe?, Pipeline and Gas Journal, September 2009.
[14] SOCAR (State Oil Company of Azerbaijan Republic) holds 68 % of TANAP, BOTAS ([Turkish] Petroleum Pipeline Corporation) and TPAO (Türkiye Petrolleri Anonim Ortaklığı, Turkish Petroleum Corporation) 20 %, while BP has 12 %.
[15] The main shareholders of TAP are SOCAR, Statoil, BP, Fluxys, Enagás and Axpo. See
TAP at a glance.
[16] See European Union's Nabucco pipeline project aborted, WSWS, 13 July 2013.

Map 2:
The Trans-Anatolian Natural Gas Pipeline & Trans-Adriatic Pipeline (TANAP)

Source: BP[17]

3.3 The Commission's comments on South Stream

In 2013, the European Commission expressed a negative opinion of South Stream.

While the cancellation of the Nabucco project yielded positive outcome for South Stream, Gazprom still had to face the legal concerns expressed by the European Commission in 2013[18]. At that moment, the South Stream project appeared not to comply with EU energy regulations in the Third Energy Package, and particularly with the EU's 'unbundling rule'. The unbundling provisions of the Package stipulate that the owners of generation and sale operations should be different of the owners of the transmission networks.

The principal points of friction were the EU's third-party access rules, the price of gas and Gazprom's monopolistic position.

Indeed, Russia has long desired to control all aspects of the gas market. This has meant a 'vertical integration' of the production and distribution structures – supervising the entire process of producing, transporting and distributing gas. The same state-controlled company, Gazprom, oversees everything from the gas fields to the customers.

The opposition to the project was thus mainly due to Gazprom's opposition to third parties' access to the pipeline, the proposed tariffs and Gazprom's monopolistic position as the owner of both the transmission network and the gas to be transported.

The Commission asked Gazprom and Member States to renegotiate their intergovernmental contracts in accordance with EU law. As a response, the Russian authorities challenged the Third Energy Package to the Dispute Settlement Body of the World Trade Organisation (WTO) on 30 April 2014[19,20]. Moreover, expressing their dissatisfaction with the Commission's decision, the leaders of Austria, Bulgaria, Croatia, Greece, Hungary, Italy, Serbia and Slovenia sent a

[17] See Shah Deniz Stage 2, BP.
[18] See South Stream bilateral deals breach EU law, Commission says, Euractiv, 5 December 2013.
[19] See Dispute Settlement: Dispute DS476 (European Union and its Member States — Certain Measures Relating to the Energy Sector), 22 June 2015.
[20] This case, however, has not shown any progress since the request of consultations on 30 April 2014 in addition to the fact that no official panel has yet been appointed.

joint letter to Commission President José Manuel Barroso in June 2014 in support of the South Stream project[21].

Despite their discontent, the Commission stood firm on its position. Vice-President Maroš Šefčovič said in October 2014, 'when it comes to the operation of Russian companies on European soils, they have to respect European rules. [It] is absolutely unequivocal and very clear.'[22]

In November 2014, Hungary nonetheless announced its intention to continue developing the South Stream project, adapting its regulation to make the construction of the Russian pipeline possible – despite the opposition of the European Commission[23].

4 Russia's evolving strategy

Despite the cancellation of the Nabucco project, Gazprom was still faced with new competitors – TANAP/TAP – as well as the attention of the European Commission. This situation triggered a drastic change in the Russian energy strategy in south east Europe.

4.1 From South Stream to Turkish Stream

On 1 December 2014, Russia and Turkey announced the end of South Stream and the creation of Turkish Stream.

In response to the Commission's position on the South Stream project, Russian President Vladimir Putin and Turkish President Recep Tayyip Erdoğan jointly announced the cancellation of Gazprom´s South Stream project and its replacement by the Turkish Stream project at a joint conference in Ankara on 1 December 2014[24].

Turkish Stream is expected to be composed of four pipelines, following a similar route to South Stream for roughly two thirds of its off-shore route, but leading to Tharce (in western Turkey) instead of Bulgaria (*See Map 3*). Its final capacity is to be around 63bcm per year. By comparison, all the gas transiting through Ukraine represents more than 80bcm[25] per year.

Turkish Stream will be 100 % Russian.

While the cancelled South Stream project involved the Italian oil and gas company ENI, the French EDF and the German Wintershall, only Gazprom is expected to direct Turkish Stream's offshore project[26,27].

Russians officials have stated that if the negotiations progress, gas

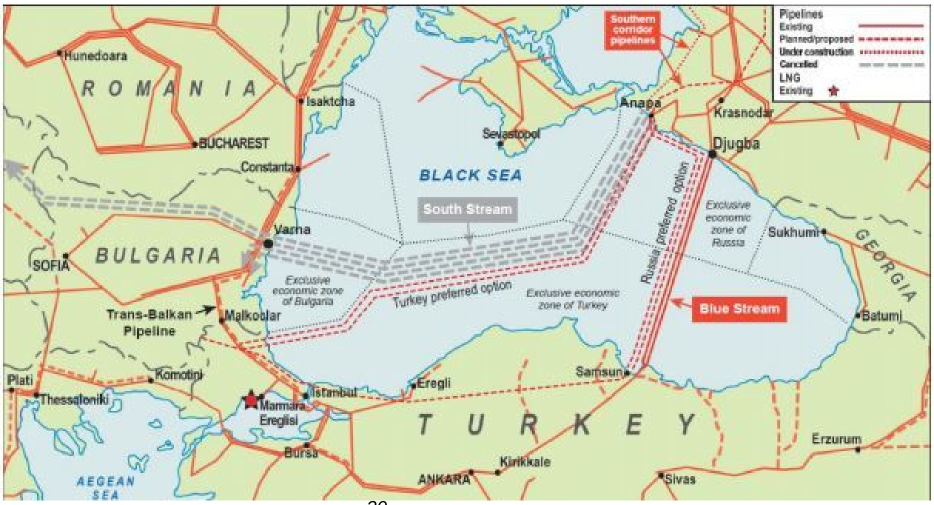
[21] See Renzi leads belated effort in support of South Stream, Euractiv, 10 June 2014.
[22] See Commitments made at the hearing of MAROŠ ŠEFČOVIČ Vice-President of the Commission, Commissioner for Energy Union, European Commission, October 2014.
[23] See Hungary attempts to bypass EU law on South Stream, Euractiv, 5 November 2014.
[24] See News conference following state visit to Turkey, 1 December 2014.
[25] See Table 1.
[26] The Turks seem nonetheless to have accepted to participate to the on-shore part of the pipeline while they declined participation on its off-shore section.
[27] See Italian Saipem may receive Gazprom's order to construct alternative pipe to Turkey, Rusmininfo, 18 February 2015.

could be delivered by the end of 2016. Turkish authorities, on the other hand, expect the project to continue for at least two and half years.

The pipeline will bring 63 billion cubic metres (bcm) to the Turkish-Greek border each year.

Given the 63 bcm of gas per year that this project would bring to the Turkish-Greek border, several European countries have expressed an interest in building the infrastructure to carry Gazprom's gas to their European clients through the Balkans. Bulgarian Prime Minister Boyko Borissov, for example, has planned to connect Bulgaria to Greece to access TANAP as well as Turkish Stream. From Bulgaria, Russia's gas could be exported on to Romania and Hungary[28]. For this to happen, Nabucco-West would serve the successor of its former competitor, the abandoned South Stream project.

Map 3:
Turkish Stream[29]



Source: Bosphore Energy Club[30]

4.2 Statement of the Commission President

On 4 December 2014, after it became clear that Turkish Stream would replace South Stream, Commission President Jean-Claude Juncker gave a joint press conference with Prime Minister of Bulgaria Boyko Borissov in which he said that the legal issues concerning South Stream were not, in fact, insurmountable[31].

Commission President Jean-Claude Juncker has said, 'South Stream can be built'.

President Juncker both supported the conclusions of the Commission and declared, 'South Stream can be built'. This surprising – and apparently contradictory – assertion confirmed that some intergovernmental agreements contravened EU law while leaving the door open for possible resolution of the Russian project.

South Stream and Turkish

The Commission did not express a preference for South Stream or

[28] See Is Nabucco-West Revivable?, Natural Gas Europe, 10 March 2015.
[29] The 'Turkish preferred option' (see Map) seems to have been chosen. It is largely overlapping the 'old' South Stream route, which was in an advanced phase when it was dismissed.
[30] See Regional Oil and Gas Fields and Pipeline Maps.
[31] See Statement by President Juncker following his meeting with Boyko Borissov, Prime Minister of the Republic of Bulgaria, European Commission, 4 December 2014.

Stream would have a similar impact on energy security.

Turkish Stream proposals – both of which would create a new route in bringing (the same) Russian gas to Europe. For the EU, the energy security benefits of South Stream and Turkish Stream involving avoiding gas transit through Ukraine. Both routes diversify supply routes ... although not supply sources[32].

4.3 Turkish Stream and EU regulation

A European antitrust investigation against Gazprom started in 2012.

In addition to facing criticism from the Commission relating to the South Stream project, Gazprom has been investigated by European antitrust authorities since 2012 for allegedly failing to apply Europe's competition rules.

A Statement of Objections was sent on 22 April 2015.

The results of the preliminary antitrust investigation, targeting Gazprom's potential abuse of a dominant position in Europe, were announced by EU Competition Commissioner Margrethe Vestager on 22 April 2015[33]. A Statement of Objections was formally presented to Gazprom, in which the Russian company was charged with 'pursuing an overall strategy to partition Central and Eastern European gas markets'[34]. Three main elements noted by the Commission were: territorial restrictions (i.e. export bans and destination clauses[35]); an unfair pricing policy (for Bulgaria, Estonia, Latvia, Lithuania and Poland, where the price of gas is notably higher than Gazprom's production costs); and Gazprom's requirement that buyers invest in gas transport infrastructure (its supply of gas was made conditional on beneficiary countries' investments in pipeline projects supported by Gazprom).

Gazprom could face a fine of EUR 9.2 billion.

If Gazprom is convicted, the company faces a penalty that could be as high as 10 % of its annual revenues – a penalty of EUR 9.2 billion based on 2013 revenues[36]. Under the EU's antitrust procedure, Gazprom has 12 weeks to answer the Statement of Objections.

The potential consequences of this antitrust battle for Gazprom's business in Europe – which could be greater than the consequences of the EU's cases against Microsoft and Google – may be one of the reasons that Gazprom has recently embraced Turkish Stream. The new route, which is outside the jurisdiction of the EU, would represent an 'anticipated response' to the antitrust case.

[32] In the European Parliament resolution of 12 June 2012 on Engaging in energy policy cooperation with partners beyond our borders: A strategic approach to secure, sustainable and competitive energy supply, the European Parliament stresses that the European energy security should be improved by 'increased diversification of supply sources – including new sources of energy – and transit routes and the development of EU sources of renewable energy'.
[33] See Commission charges Gazprom, Politico, 22 April 2015.
[34] See Antitrust: Commission sends Statement of Objections to Gazprom for alleged abuse of dominance on Central and Eastern European gas supply markets, European Commission, 22 April 2015.
[35] Destination clauses are clauses requiring the purchased gas to be used in a specific territory.
[36] See EU charges Gazprom with Gas Market Violations, Handelsblatt, 30 April 2015.

The shift from South Stream to Turkish Stream could be interpreted as Gazprom's move in anticipation of the European Commission's decision.

In any case, the decision to abandon South Stream for Turkish Stream illustrates Gazprom's changing strategy. Several factors may have encouraged the company to rethink its traditional approach: changes in EU regulations with the Third Energy Package, the entry of the United States in the gas market, the development of liquefied natural gas (LNG), international sanctions and the drop in global oil and gas prices. As a result, Gazprom's new European approach now appears to involve simply bringing its gas to the EU's borders, then letting EU Member States do the rest.

Positioning a gas hub on the Turkish-Greek border[37] – with a major gas storage facility in the Ipsala district of Turkey, where TANAP is also to end and connect with TAP[38] – would allow Gazprom to control the flow of gas while bypassing Ukraine and avoiding intergovernmental agreements that would come under the scrutiny of the European Commission. The connections between the gas hub and the final markets would be completed by interested EU Member States and by Balkan States.

By stopping at the Turkish-Greek border, Gazprom would not be subject to the EU's Third Energy Package.

With such a structure, the Turkish Stream project would both abide by EU regulation and conform to a typical Russian corporate structure, based on vertical control of the gas sector. Moreover, the risks encountered in transit countries – formerly Gazprom's problem – would be borne by European gas companies[39]. In exchange, Gazprom would renounce its continuous control of the flow of gas from the fields to the final consumers.

5 Impact of the Ukrainian crisis on energy strategies

The EU's new and ambitious Energy Union and the Ukrainian crisis meant that the competition between Turkish Stream and TANAP/TAP was imbued with a new, geopolitical character.

5.1 The Energy Union

The Energy Union was conceived to improve the EU's energy security.

Following these significant changes in pipeline projects and strategies, as well as in international energy markets and security contexts, Commission Vice-President Maroš Šefčovič announced the creation of an 'Energy Union' on 25 February 2015[40].

In part, the project serves to increase the EU's energy security by diversifying supplies (sources, suppliers and routes) and by creating a more integrated, mutually-supportive and transparent European energy market. The Energy Union incorporates energy security

[37] See A Turkish View: Eurasian Stream for a Eurasian Gas Hub, Natural Gas Europe, 23 February 2015.
[38] See Repercussions of Turkish Stream for the Southern Gas Corridor: Russia's New Gas Strategy, Natural Gas Europe, 16 April 2015.
[39] See Gazprom's evolving strategy in a new commercial and political context: how should the EU react?, Marcos Giuli, European Policy Centre, 27 April 2015.
[40] See Energy Union Package, European Commission, 25 February 2015.

Russia will remain an essential energy supplier.

aspects, energy efficiency goals and CO2 reduction objectives. It also confirms the Russian Federation's status as an indispensable source of energy for Europe – though one that must comply with EU legislation. In a speech on 24 March 2015 to the European Parliament Delegation to the EU-Russia Parliamentary Cooperation Committee, Vice-President Šefčovič said, 'energy plays a pivotal role in our relations with Russia, and Russia plays an important role in our energy policy'.

While the Energy Union seems in this way not intrinsically opposed to Russia, Vice-president Šefčovič nevertheless suggested that future projects would work towards diversifying the EU's energy mix.

The EU will prioritise projects bringing greater diversification.

Vice-president Šefčovič further developed this strategy in October 2014, when he declared that '[The European Union] should work intensely on the Southern Corridor to get Caspian gas to Europe. [The EU] must further develop our partnership with Norway and promote the Mediterranean gas hub project, including developing energy cooperation with Algeria. Moreover, the development of LNG terminals opens new import possibilities. [...] So my clear preference is to diversify energy sources and to do our utmost to get the Southern Corridor project well under way and to put our financial and political support firmly behind this project.[41]'

His statement, which followed the publication of the European Energy Security Strategy[42] and the updated list of Projects of Common Interest[43], confirmed that the Energy Union supports projects such as TANAP, which expand the variety of energy suppliers, rather than simply create new supply routes.

5.2 Division among EU Member States vis-à-vis Russia

The EU's economic sanctions against Russia have been in place since 2014.

Following the Ukrainian crisis and the annexation of Crimea by Russia in March 2014, the European Union decided on 17 March 2014 to impose economic sanctions on Russia in response to these illegal acts. These consisted of restrictive measures – including travel restrictions and asset freezes – on specific persons and entities[44]. Further sanctions[45] were added in the course of 2014[46].

[41] See Commitments made at the hearing of MAROŠ ŠEFČOVIČ Vice-President of the Commission, Commissioner for Energy Union, European Commission, October 2014.
[42] See Energy Security Strategy, European Commission
[43] See Project of Common Interest/Cluster of PCIs, European Commission, 9 January 2014.
[44] See EU sanctions against Russia: New targets and state of play, DLA Piper, 11 February 2015.
[45] See European sanctions against Russia, Europeansanctions.com
[46] Up to date, the European sanctions consist of four types of restrictive measures: Individual restrictive measures; Restrictive measures in response to the illegal annexation of Crimea and Sevastopol; 'Economic sanctions' - measures targeting exchanges with Russia in specific economic sectors; Measures concerning economic cooperation.

One year after the beginning of the crisis, the European Council agreed to prolong the sanctions on Russia[47]. The individual restrictive measures[48] were extended until September 2015, while the sectorial sanctions[49] were aligned with the full implementation of the Minsk agreements; their prolongation has been discussed and decided by the Council of the EU on 22 June 2015 until 31 January 2016[50].

The sanctions and the fall in oil and gas prices have greatly affected Russia's economy.

To pressure the Russian government, the European Union prohibited certain financing/investment transactions with defence and energy companies, as well as with Russian institutions. New loans or credits with a maturity exceeding 30 days to persons and entities on the list of EU restrictive measures were also banned. The EU restricted the sale, supply and export of oil exploration and production technologies, products and services in Russia and its Exclusive Economic Zone and Continental Shelf[51]. These sanctions targeted the heart of the Russian economy – its energy sector.

The duration of the sanctions has been extended on 22 June 2015 by the Council of the EU.

The combination of these sanctions and the global fall in oil and gas prices has led to suffer significant economic losses for Russia. The country's population and its energy companies have been affected, as have its close economic partners in Central Asia and Eastern Europe[52].

The complex political relations between Europe and Russia are intertwined with their energy interests.

In the Council, prolonging sectorial sanctions requires a unanimous vote – a procedure that gives the EU's Member States in the south-east leverage to exert pressure in favour of Turkish Stream. Not surprisingly, countries that would directly benefit from Turkish Stream – and its extension into Austria – argued against further sanctions against Russia[53].

Five European countries have cultivated close tights with Russia and supported its Turkish Stream project.

In fact, as the European Council was discussing sanctions against Russia, officials from south-eastern Member States continued to meet with Russian officials. In one such meeting in April 2015, representatives of Cyprus, Italy, and Hungary met with Russian authorities to discuss economic cooperation, including energy matters. In another, highly publicised encounter, Greek Prime Minister Alexis Tsipras visited Moscow, where his discussion with President Putin touched on the future development of Turkish Stream[54]. These points

[47] See EU restrictive measures in response to the crisis in Ukraine, European Council, accessed on 24 April 2015.
[48] EU Council Regulation 269/2014 implemented on 17 March 2014 and subsequently amended.
[49] Imposed by EU Council Decision 2014/512 and EU Council Regulation No 833/2014 of 31 July 2014 subsequently extended on 12 September by the EU Regulation 960/2014.
[50] In order for the economic sanctions to be extended, a unanimity vote was required.
[51] See EU Council Regulation No 1290/2014.
[52] See Sanctions & Oil Prices Bring The Russian Economy Near Collapse, Investopedia, 21 January 2015.
[53] See Seven EU Countries to oppose New Anti-Russian Sanctions at Summit, Sputnik News, 18 March 2015.
[54] During the joint press conference with Russian President Vladimir Putin, Tsipras pointed out that he would be dissatisfied with the name of the pipeline if it passed

of contact reflect the complex state of relations between the European Union, the European Member States and the Russian Federation[55].

Once Turkish Stream becomes operational, gas flows through Ukraine might be stopped from 2019.

Even without Russia, discussions have continued on energy plans for the south-east that would involve Gazprom. In a meeting in Budapest in April 2015, representatives of Hungary, Serbia, the former Yugoslav Republic of Macedonia, Greece and Turkey discussed the project for Turkish Stream[56]. According to the participants' final declaration, the line could be extended beyond Turkey to Austria. It would ensure a greater diversification of gas routes and enlarge Europe's 'energy mix' with new sources of gas.

Russian officials have pointed to other advantages to the route: if gas flows to Europe via Ukraine were halted following the termination of existing transit contracts, Europe could continue to receive Russian gas via Turkey from the year 2019[57].

The EU's current political crisis with Russia has generally run in parallel to the competition of Turkish Stream and TANAP. The pipeline 'rivalry' is a multi-faceted one, encompassing economic factors, legal issues (the antitrust case) and geopolitical considerations (sanctions).

5.3 TANAP/TAP change of plans

Other European countries have supported the Trans-Adriatic Pipeline (TAP) to bring gas from Turkey to southern Europe.

Following the meeting in Budapest in April 2015, the spokesperson for TAP noted that the pipeline would be open to new shareholders – possibly Iran and/or Russia – in its second phase[58] in accordance with EU legislation in the Third Energy Package[59].

Although TAP is a part of the European gas network, and therefore subject to EU regulation, the European Commission granted the pipeline a 25-year exemption from the unbundling rules during its first phase, after the Italian, Greek and Albanian authorities requested it[60]. As of today, TAP can therefore be owned by the same companies as the ones exploiting the gas. The TAP consortium is then not likely to open the pipeline to its competitor Gazprom to send gas to Europe. The opening of TAP's second phase provides a new opportunity for

The Trans-Anatolian

through Greece. See Tsipras: 'Turkish Stream' will have another name on Greek territory, Euractiv 9 April 2015.

55 See Russia targets Cyprus, Hungary, and Italy for sanctions veto, EU observer, 11 December 2014.

56 See Infrastructure in Central & SE Europe: In the Wake of South Stream, Natural Gas Europe, 8 April 2015.

57 See Russia to stop gas delivery via Ukraine by 2019, push ahead with Turkish Stream - Miller, RT, 13 April 2015 and Turkish Stream Route Might Be Extended, Novinite, 15 April 2015.

58 The development of TAP, starting in 2016, is composed of two phases: the first phase bringing 10bcm/year of Azeri gas coming from TANAP via the Turkey; and the second phase expanding the capacity of TAP to 20bcm/year.

59 See TAP pipeline open to other shareholders, including Iran, Euractiv, 09 April 2015

60 See Commission decision of 16 March 2013.

Natural Gas Pipeline (TANAP) would bring Azeri gas to Europe via Turkey.

Russian companies to enter the European market with gas supplied through the future Turkish Stream[61].

Unbundling rules should also apply to the Trans-Anatolian Natural Gas Pipeline (TANAP) when Turkey will break up its national energy system in line with the EU policy. A draft law on this subject is currently being discussed in the Turkish Parliament. If passed, TANAP, conceived to deliver Azeri gas to the southeast of Europe, could be used to carry gas of multiple origins and suppliers. However, legislative congestion in the Turkish Parliament means the law is unlikely to be examined before the country's new parliament is settled in place after the parliamentary elections of 7 June 2015[62].

6 Turkish Stream, TANAP/TAP and Ukraine

Ukraine is at once a transit country between Russia and the EU … and one embroiled in a violent conflict pitting Russian-speaking separatists against an EU-oriented government. It is therefore hardly surprising that the competition between the Russian-led and European-backed gas projects has also involved the country.

6.1 The European's alternative routes to Ukraine

Major geopolitical changes are expected if Russia stops delivering gas through Ukraine.

If Russia does build Turkish Stream and reroute the gas currently transiting through Ukraine, there is likely to be a major geopolitical impact.

As a consequence, most countries relying on gas transiting via Ukraine (*see Table 1*) already try to adapt their energy strategy to limit their dependence on gas shipped through Ukraine.

An overview of the different strategies shows that:

- In the aftermath of the 2009 gas crisis, Germany built Nord Stream connecting the German market to Russia via the Baltic Sea (*see Map 3*). Thanks to this pipeline, functional since 2012, the EU's gas supply situation has shifted tremendously: in 2014, only 53 % of the Russian gas exports to Europe were transported via Ukraine, in comparison to 80 % in 2009[63].
- Albania, Greece, Italy and Turkey are currently working on construction of TANAP/TAP.
- Austria, FYROM, Greece, Hungary, Macedonia and Serbia support the Turkish Stream project.

It remains uncertain what strategy EU countries will

[61] See Russia can use Trans-Adriatic pipeline, Commission confirms, Euractiv, 02 April 2015.
[62] See Liberalizing Turkey's Gas Market: BOTAŞ Loosening the Reins, Natural Gas Europe, 2 March 2015.
[63] See Russian-Ukrainian-EU gas conflict: who stands to lose most?, Nato Review Magazine, 2014.

adopt regarding their dependency on Ukraine.

- Bulgaria, Greece and Romania signed an agreement on 22 April to interconnect their market and built a gas corridor to Greece in order to access Azeri gas (thereby reviving the Nabucco-West project)[64].

All these projects have one main feature in common: avoiding gas transit via Ukraine.

Table 1: Russian gas transit through Ukraine to European countries, billion cubic metres (bcm) per year

Country	2013	2012
Italy	25.33	15.08
Turkey	13	14.02
Germany	11.71	21
Czech Republic	7.32	7.28
Hungary	6	5.29
Slovakia	5.42	4.19
Austria	5.23	5.22
France	3.21	3.04
Bulgaria	2.76	2.53
Greece	2.63	2.5
Romania	1.19	2.17
Serbia	1.16	0.74
Slovenia	0.54	0.5
Switzerland	0.37	0.3
Bosnia-Herzegovina	0.19	0.26
Macedonia	0.04	0.08
Total	**86.1**	**84.2**

Source: Oxford Institute for Energy Studies[65]

6.2 Ukraine: An integral part of the European energy market

Despite this effort to bypass Ukraine for gas imports, European countries have also made great efforts to support Ukraine in its crisis and fully integrate the country in the European energy market.

Several interconnectors between the EU and Ukraine have been built.

The gas connections between Ukraine and Poland, Hungary and Slovakia, allowing exports from the EU to Ukraine, have proved their value since 2013, and will certainly play a more and more important role in the future[66]. Since the 2014 East Ukrainian crisis, substantial amount of gas has been exported from the European Union to the

[64] See Balkan Countries Sign Gas Pipeline Agreement, Balkan Insight, 23 April 2015.
[65] See What the Ukraine crisis means for gas markets, Oxford Institute for Energy Studies, March 2014.
[66] See Ukraine: Europe's Last Gas Frontier?, Natural Gas Europe, 28 April 2015.

western part of Ukraine (*see Table 2*).

While Ukraine is a transit country, it also imports a substantial share of gas from the EU.

Notwithstanding the pressures exerted by Gazprom on European countries re-exporting Russian gas to Ukraine[67,68], the share of gas coming from the European Union to the Ukrainian market has tremendously increased in 2015; the share may now be as high as 50 %[69].

Ukraine is therefore now both a transit country for Russian gas destined for the European Union, and an importer of Russian gas from the European Union.

Table 2:
Reverse flows from the EU to Ukraine

EU Country	Reverse flow, BCM	
	2014	Q1 2015
Hungary	0.6	0.3
Poland	0.9	0.03
Slovakia	3.6	3.3
Total	**5.1**	**3.6**

Source: Natural Gas Europe[70]

Commission Vice-President Šefčovič stated on 28 April 2015 that, following the Ukrainian government's recent reforms in the energy sector, the compatibility of Ukraine's legislation with the Third Energy Package and the future European Energy Union could be achieved rapidly[71].

Under the condition that the country's energy sector undergoes a deep reform, Ukraine could become an integral part of the European energy market in a near future.

6.3 Ukraine as a transit-free country

European countries want to decrease their dependency on Ukraine.

A number of factors have made it significantly more likely that Ukraine will be bypassed by Russian gas in the foreseeable future: Gazprom has announced it intends to stop routing its gas through Ukraine from 2019; the Turkish Stream project is advancing; and a number of European countries have adopted strategies that would allow them to bypass Ukraine in order to diminish their dependency on both Kiev

[67] See Gas war escalates as Russia halves Slovakia supplies, EU observer, 2 October 2014.
[68] See Russia threatens EU states with gas cut-offs, EU observer, 26 September 2014.
[69] See Ukraine as part of the European energy market - speech by Vice-President Šefčovič at the Energy panel at International Conference for Reform in Ukraine, European Commission, 28 April 2015.
[70] See Ukraine: Europe's Last Gas Frontier?, Natural Gas Europe, 28 April 2015.
[71] See Ukraine as part of the European energy market - speech by Vice-President Šefčovič at the Energy panel at International Conference for Reform in Ukraine, European Commission, 28 April 2015.

and Moscow.

Vice-President Šefčovič's declaration in support of Ukraine's long-term prospects as a transit route[72] does not wipe out the dark clouds on the horizon of Europe's main gas transit route. If Gazprom continued to send its gas through Ukrainian territory, that would provide Ukraine with a stable income in transit fees – as well as leverage in its currently tense relationship with Moscow[73,74].

The Ukrainian authorities have declared their wish to continue serving as a transit route for Russian gas to Ukraine and to further exploit domestic gas reserves[75]. These are currently underdeveloped because of market regulation and low-cost (subsidised) Russian gas imports[76,77].

For its part, the Russian Federation wishes to continue supplying gas to Ukraine, which is a major consumer: despite a steady decline, Ukraine still consumed in 2013 roughly the same quantity of gas that Turkey and France did – 45bcm per year[78]. Yet Russia also wants to stop using Ukraine as a transit route.

If Gazprom stopped sending gas through Ukraine, the country might face a difficult fate.

If Russia were to completely halt its gas transit through Ukraine, two possible scenarios for Ukraine could be envisaged:

In one, negative scenario, Ukraine would be at the mercy of its Russian neighbour.

- If Ukraine needs to continue importing gas from Russia, Kiev's loss of leverage over Russia (currently based on its control of the transit pipelines) could lead to a very uncomfortable situation. Kiev would have a poor negotiating position for discussing gas prices with Russia, and would likely be required by Moscow to pay a much higher price. This would have significant negative short-term effects on the Ukrainian economy (e.g. the loss of around EUR 3 billion per year of transit fees[79]).

  Moreover, if Ukraine's domestic production does not satisfy domestic demands in the long term, the country could also face disastrous political and economic consequences in the event of a shortage of Russian gas. And if Europe continues to use as much Russian gas – from both Nord Stream and Turkish Stream – the European Union would not have much power to mediate a potential crisis. Finally, if European companies were also the owners of Europe's gas pipelines – the outcome of Gazprom's new strategy – they would have to bear the risks of disruption. Knowing this, European investors would be likely to avoid

[72] See Ukraine's energy system ready to provide for stable gas transit to Europe, says Ukrainian premier, European Dialogue, 10 December 2014.
[73] See Gazprom puts the squeeze on Ukraine, Politico, 26 February 2015.
[74] See Naftogaz Is Ukraine's Achilles' Heel, Carnegie Europe, 3 November 2014.
[75] See Ukraine seeks international partner for gas production project, Interfaxenergy, 23 April 2015.
[76] See Ukraine to revisit gas production taxes, Kyivpost, 14 April 2015.
[77] See The Role of Russian Gas in Ukraine, Natural Gas Europe, 18 April 2014.
[78] See BP Statistical Review 2014.
[79] See What the Ukrainian crisis means for gas markets, The Oxford Institute for Energy Studies, March 2014.

unstable transit countries such as Ukraine.

Instead of today's complicated state of interdependency, the future might make Ukraine far more fragile and dependent on Russia.

But there are also positive outcomes that could be imagined – more like the example of Moldova.

- If Ukraine were to be completely integrated in the European gas network and stop importing gas directly from Russia, the tensions created by the current gas interdependency between Ukraine and Russia would likely be greatly diminished.

  The relationship between Kiev and Moscow might evolve further if the conflict in eastern Ukraine were resolved: Ukraine's situation would be more like that of Moldova, a country seeking a balance between two nearly-equal partners.

7 Consequences for Europe and beyond

In its wide-ranging confrontation with countries to its west – and with the EU in particular – the Russian Federation has proven that energy dependency can be dangerous, and that energy can serve as a sort of weapons.

The sword of Damocles hanging above Europe's gas market has triggered the EU to profoundly change its approach *vis-à-vis* Russian and Russia's once-dominant position in the European gas market. What was once seen as a symbiotic relationship – or at least an unavoidable partnership – is now perceived as an unwanted dependency.

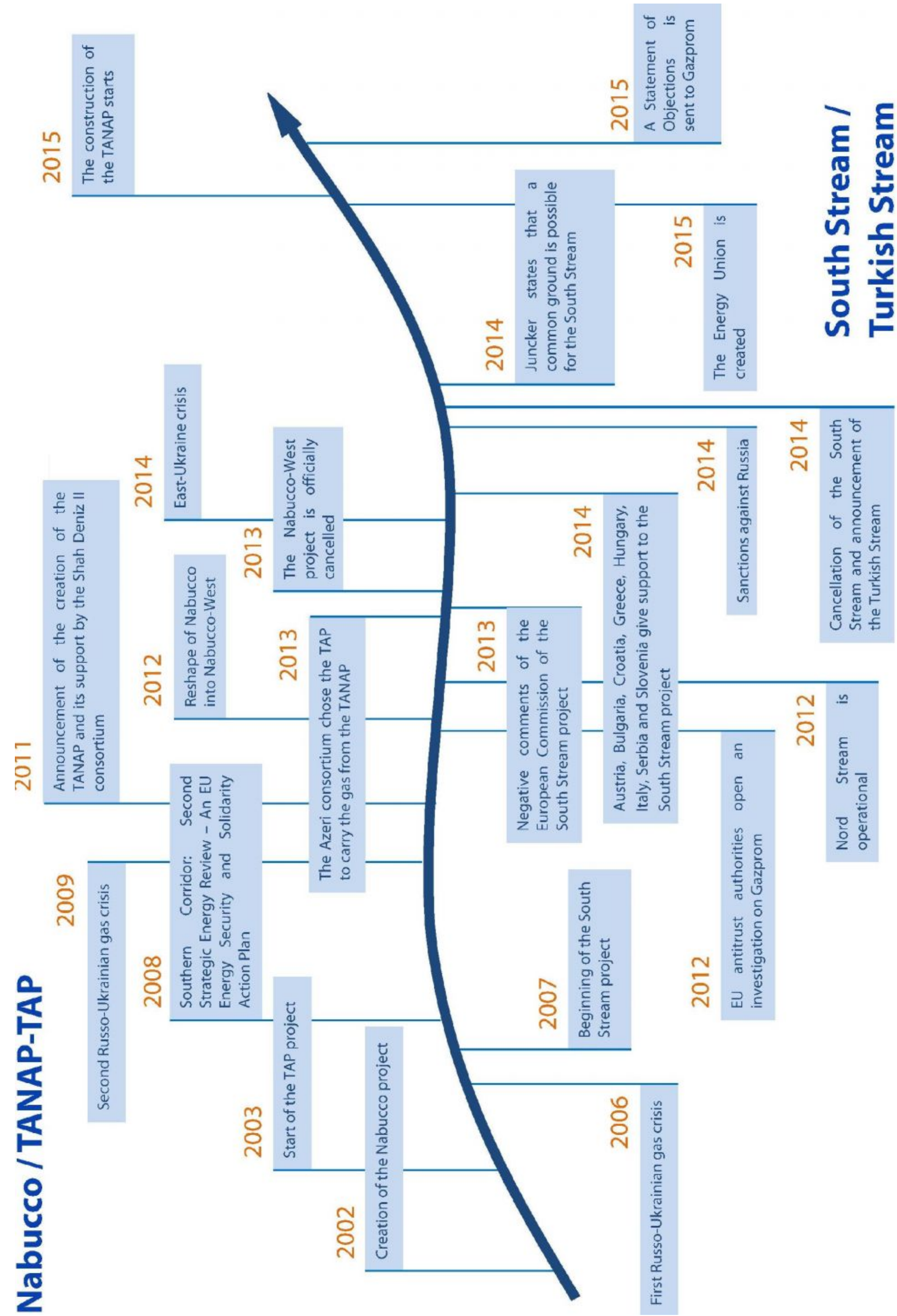
Diversifying supply routes and sources have become the new priorities of the EU's energy policy, as illustrated with the Energy Union.

Yet Russia will not easily accept its declining influence in the European market. Gazprom has proven agile enough to change its strategy. The shift from South Stream to Turkish Stream illustrates the altered situation in south-eastern Europe: Azeri gas will be welcomed, the Energy Union implemented, and the EU's antitrust case may have manifold consequences.

Caught in this confrontation between the EU and Russia, Ukraine risks becoming a collateral victim. Once the main link between its two neighbours, Ukraine is now avoided by both the EU and Russia.

The consequences of the changing 'gas landscape' in south-eastern Europe are, however, not limited to Europe. Gazprom's increasingly limited prospects in Europe provide Russia with a strong incentive to secure new markets. The company has already affirmed its intention to focus more on Asia. While the situation in Ukraine and the EU is for now the main concern of EU stakeholders, the most important result of the dispute may be this: Russia's pivot away from the EU.

8 Appendix


Nabucco / TANAP-TAP
South Stream / Turkish Stream
2002
Creation of the Nabucco project
2003
Start of the TAP project
2008
Southern Corridor: Second Strategic Energy Review – An EU Energy Security and Solidarity Action Plan
2009
Second Russo-Ukrainian gas crisis
2011
Announcement of the creation of the TANAP and its support by the Shah Deniz II consortium
2012
Reshape of Nabucco into Nabucco-West
2013
The Azeri consortium chose the TAP to carry the gas from the TANAP
2013
The Nabucco-West project is officially cancelled
2014
East-Ukraine crisis
2015
The construction of the TANAP starts
2006
First Russo-Ukrainian gas crisis
2007
Beginning of the South Stream project
2012
EU antitrust authorities open an investigation on Gazprom
2012
Nord Stream is operational
2013
Negative comments of the European Commission of the South Stream project
2014
Austria, Bulgaria, Croatia, Greece, Hungary, Italy, Serbia and Slovenia give support to the South Stream project
2014
Sanctions against Russia
2014
Cancellation of the South Stream and announcement of the Turkish Stream
2014
Juncker states that a common ground is possible for the South Stream
2015
The Energy Union is created
2015
A Statement of Objections is sent to Gazprom