

ACTION FICHE FOR 2008 ENPI-EAST ANNUAL ACTION PROGRAMME

1. IDENTIFICATION

Title	Pre-investment project for the implementation of the Trans-Caspian - Black Sea Gas Corridor - CRIS n° 2007/19599		
Total cost	EC contribution: 5 M €		
Aid method / Management mode	Project approach: centralised management		
DAC-code	23050	Sector	Gas distribution

2. RATIONALE

2.1. Sector context

Energy supply, conservation and diversification have become nowadays an overriding challenge for the EU and its Eastern European and Central Asian partners. Uncertainties over reserves, added to stronger international competition for access to hydrocarbon sources have boosted oil and gas prices, highlighting the need for Europe and its neighbours to develop more integrated, regional energy markets. Energy supply has become an integral element of security, not only due its impact on economic activity and social welfare, but also because it appeared to be a political lever.

As a result, a major overhaul of EU energy policy, including with regard to its external dimension, was carried out in 2006. This process started with the EC Green Paper ("A European Strategy for Sustainable, Competitive and Secure Energy") in March, was reasserted by the Commission, the Secretary-General and the High Representative for the European Council in a common paper advocating a renewed EU strategy for external energy relations issued in May, and culminated in the orientations adopted at the Heads of States' Summit in Lahti on 20 October 2006.

In the framework of the Strategic EU Energy Review published in January 2007, the priorities proposed by the Commission regarding external policy aspects include: strengthening EU relationships with its neighbours; contributing to the improvement of legal frameworks to facilitate investments in international projects; developing financial instruments to enhance energy security through inter alia enhanced cooperation with the EIB and the EBRD; and encouraging energy efficiency and the development of renewable energies.

These goals are fully consistent with the EU's international commitments (Kyoto Protocol, UNFCCC, and MDGs - especially in relation to environmental sustainability).

The European Council meetings of June and December 2006 and of March 2007 endorsed this approach.

In the ENPI-East Regional Indicative Programme for 2007-2010, the priority assigned to the energy sector is to "enhance regional cooperation and cooperation with the EU in the fields of energy supply and demand, safety and security of energy systems, and the gradual integration of energy markets".

At the bilateral level, Memoranda of Understanding were signed between the EU and Ukraine, Azerbaijan and Kazakhstan and political dialogue with Russia was reactivated. Negotiations of an energy-related MoU are underway with Turkmenistan.

With regard to Armenia, Azerbaijan, Georgia, and Ukraine, ENP Action Plans incorporating energy-related aspects, have been agreed and are currently implemented.

As far as EU relations with the regions of Eastern Europe and Central Asia are concerned, the process initiated in November 2004 in Baku, Azerbaijan, with the aim of strengthening inter-regional energy cooperation was accelerated and intensified. An Energy Ministers' conference held in Astana, Kazakhstan in November 2006 provided directions for future cooperation, with a particular focus on increasing convergence of energy markets, enhancing energy security, promoting energy sustainability, as well as attracting investments. The EU-funded INOGATE programme has taken up these objectives. This project will be part of this programme.

Diversification of gas supply sources as well as increased tapping of the substantial reserves available in the Caspian region have become an overriding challenge for the EU, in the light of growing gas demand and of the gradual depletion of the North Sea reserves. For the producing countries of the Eastern European and Central Asian regions, such as Azerbaijan, Kazakhstan and Turkmenistan, as well as for transit countries such as Georgia and Ukraine, developing a southern gas supply route, free from Russian control, through Eastern Europe to the EU is also an essential objective, both from a political and from an economic viewpoint. The envisaged project is expected to establish the technical, legal, and financial foundations that are necessary to launch the engineering phase of this major gas interconnection infrastructure.

2.2. Lessons learnt

The following goals are specifically mentioned in the Energy Road Map annexed to the Declaration approved by the Ministers of Eastern Europe and Central Asia¹ at their meeting in Astana in 2006:

- Diversifying, in Eastern Europe and the Caucasus, energy transit infrastructure, including through the development of alternative oil and gas transit routes towards Europe;

¹ Representing the following countries: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Ukraine, Uzbekistan, Tajikistan, Turkey, Turkmenistan

- In the Central Asian region, facilitating new economically viable and environmentally sustainable energy export routes towards Partner Countries and supporting regional energy cooperation projects for the transport of energy products, as well as the development of integrated energy networks with the EU.

These statements clearly demonstrate that the Partner Countries are keen to strengthen and deepen cooperation in the field of energy and to support investments, in order to develop their economies and to mitigate the impact of increasing energy prices on their populations and businesses.

The project will address some of these expectations, while taking advantage of the strong political support manifested by the Partner Countries in Astana.

At a further meeting organised in Baku in April 2007, the governments of Azerbaijan and Georgia, represented by their respective Energy Ministers, agreed with the EC and with a high level representative from Kazakhstan that the possible options for the creation of a new gas transit corridor should be investigated.

A wide-ranging feasibility study, covering technical, financial and economic, as well as legal and environmental aspects, was launched by the EC soon afterwards. The feasibility study demonstrated the technical and financial viability of the envisaged route, of the available technical solutions and their respective costs, and provided an opportunity to verify legal and environmental aspects. Its findings and recommendations were discussed with representatives of Georgia, Azerbaijan and Kazakhstan on 30 November 2007 in Brussels and communicated to Turkmenistan. The project formulated in this action fiche originates from confirmation received from three of the four countries concerned that the EC should go ahead. A political agreement with the countries concerned, as well as a formal confirmation of their adherence, in principle, to the option proposed by the consultants to cross the Caspian Sea (barges transporting Compressed Natural Gas-CNG), are still pending.

This major investment would benefit all the countries concerned, as well as the EU, since gas suppliers have an interest to diversify their export markets and to make the best of their energy resources, and consumers are looking to secure and diversify their gas supplies, thereby also limiting price fluctuations.

2.3. Complementary actions

Preliminary work was conducted under the INOGATE programme, for example with the “Feasibility Studies for oil and gas pipelines through the Caspian Sea”, completed in December 1999, and the “Complementary feasibility studies for oil and gas from the Caspian Sea Region to Central and Eastern Europe”, completed in January 2001. Meanwhile, the global energy scene has changed completely, and so have EU energy policy and the nature of energy cooperation with its partners in the region.

This is due to geopolitical changes combined with price volatility, as a result of the increasing scarcity of fossil energy resources and fiercer international competition to secure energy supply - and more particularly gas supply, which is the cleanest and the most sought-after fossil fuel. The international context and the regional energy situations are much more conducive nowadays to the satisfactory implementation of the project and to its further developments.

Apart from the wide-ranging feasibility study mentioned in section 2.2, a more recent complementary initiative was the “Study on the Trans-Caspian Gas pipeline from Kazakhstan to Azerbaijan” undertaken in 2006 and 2007 with bilateral EC resources, following a request from the Government of Kazakhstan to the Commission’s Delegation in Astana. The results of this study were taken into account in carrying out the much larger feasibility study referred to above.

On the political side, discussions with the concerned Partner Countries were undertaken by the EC in 2007, including at Commissioner level. Continuous dialogue with each of these countries, at both operational level and higher level, are on the agenda for the first four months of 2008. Meanwhile, the EU Member States will be kept informed of the steps taken by the Commission to prepare the current project in the framework of the Energy Group of the Council.

2.4. Donor coordination

Under the INOGATE programme and in the framework of the extension phase of the feasibility study, contacts with lending institutions (EBRD, EIB, Member States’ banking institutions and the World Bank), National Coordinators of EC assistance and INOGATE Country Coordinators, as well as potential co-financiers including gas companies, are actively pursued. Regular contacts are also maintained between EC headquarters and the EC Delegations in the region, more particularly with those that are already active in the energy sector. These contacts will be extended in the course of project implementation. Synergies with other interconnection initiatives, such as the NABUCO project, will also be explored.

3. DESCRIPTION

3.1. Objectives

3.1.1. Overall objective

The overall objective of this project is to establish the conditions required for the implementation of a new gas supply route from the countries bordering the Caspian Sea (Azerbaijan, Kazakhstan, and possibly Turkmenistan) to Central and Western European countries through Georgia and the Black Sea.

3.1.2. Specific objectives

The specific objectives of the project are to:

- Clarify which routing and technical option should be selected, based on the assessment of risks, detailed environmental and social impact, and respective merits of the technical solutions that may be considered, and taking into account the position of the Partner Countries vis-à-vis the option proposed by the consultants in the feasibility study (i.e. CNG);
- Clarify the legal structure and the organisational framework necessary to manage the gas interconnection;

- Assist the parties involved, including Commission's services, in preparing a multilateral agreement specifying their respective obligations in relation to the development of the gas corridor (supply, transit and commercial aspects will have to be clarified);
- Depending on the outcome of the above activities and in agreement with the Commission, assist in the setting up of the financial structure of the future infrastructure investment.

3.2. Expected results and main activities

Project activities will include a mix of: technical and financial studies; consultation with local stakeholders' representatives and with stakeholders of other interconnection projects; business development projections; preparation of legal establishment and management scenarios; discussions and negotiations (in close coordination with the Commission) with national authorities and gas companies; and dialogue with potential financiers, including major lending institutions.

The *activities* to be carried out will include more specifically:

- Undertaking, as necessary, studies to support selection and substantiation of routing and technical options, including (but not necessarily limited to):
 - risk analyses (market, financial, geopolitical, technical);
 - environmental and social impact, as well as risk management assessments;
 - technical studies on the different sections of the gas corridor: e.g. offshore pipeline installation, all possible compressed natural gas (CNG) options, underground storage facilities, interconnections to EU networks, etc.;
- Establishing a business plan for the implementation of the gas corridor;
- Consulting with existing pipeline operators and those in charge of other possible projects, including those in the Black Sea region;
- Clarifying the legal structure of all the parties that could be involved in the gas corridor project, including gas supply and distribution companies
- Analyzing different scenarios for operating and managing the gas corridor, ensuring its financial sustainability, and finding commonly acceptable solutions regarding gas commercialization; this will entail defining its legal status, examining whether public/private partnership could be envisaged, and assisting all the parties in developing the necessary legal arrangements;
- Preparing the ground for an Inter-Governmental agreement between the countries involved (producing, transit and consuming countries), which will include a dispute settlement mechanism;
- Preparing a list of potential national and international investors;
- Depending on the outcome of the above activities and in agreement with the Commission, consulting with International Financing Institutions (IFIs) and assisting in the negotiations with these institutions, as well as with Partner Countries, other donors, major private investors, banks and insurance companies, in order to set up the financial structure of the investment project
- Carrying part of the technical engineering studies required, based on the achievements of the above results, and within the limits of the project budget.

The *results* to be achieved will include, inter alia:

- A complete picture of the risks associated with the project, and of the measures to be adopted to mitigate these;
- Technical solutions available (CNG and other options, as necessary) assessed more in-depth, so that the best and the less risky ones are retained by the Commission and the Partner Countries;
- Location of infrastructure equipments (including harbour installations, compressor stations, control systems, storage capacities, pipelines, etc) as well as delivery points, defined in detail and agreed;
- Environmental Impact Assessments carried out;
- Financial estimates specified in detail for each category of investment and overall investment cost established;
- Business plan prepared and organizational and management set up of the corridor defined and accepted;
- Organizational options proposed to operate and manage the gas corridor and to ensure gas commercialization; adoption of one of these options by stakeholders and partnerships established;
- Inter-Governmental Agreement involving producing, transit, and consuming countries finalized and signed;
- Financial scheme established with investors and financing institutions;
- Some of the technical engineering studies achieved (should the project budget permit).

3.3. Stakeholders

The project's primary stakeholders will, obviously, be the Energy Ministries and gas utilities of the Partner Countries concerned (Azerbaijan, Georgia, Kazakhstan, Turkmenistan). Contacts with EU gas companies and with international financing institutions will be developed, too.

In order to assess the value of the CNG option more in-depth, dialogue will also be ensured with the shipping industry involved in the development of this technology internationally, as well as the key representatives of this sector in the Caspian Sea and the Black Sea regions.

In order to investigate further on the CNG option, dialogue will also be ensured with the shipping industry, in particular those firms specialised in CNG-related technologies, on the one hand, and those working in the Caspian Sea and the Black Sea regions, on the other.

Meetings with representatives of the local population will be organised for the public consultation process, particularly to assess environmental and social impacts in detail.

3.4. Risks and assumptions

The infrastructure connection, which should result from this pre-investment project is complex and the risks associated to it should be fully estimated and mitigated, whenever possible, beforehand. Although the present project has precisely this purpose, it may be confronted with certain difficulties, such as: limited collaboration, or reluctance to express official support to the project on the part of the beneficiary countries and/or gas companies, due to the likely counteracting influence of powerful

energy players, such as Gazprom (particularly as far as the two Central Asian countries are concerned); reluctance to provide data on reserves, potential gas export flows and other technical details regarding e.g. the technical status of existing infrastructure; or slow decision-making processes in relation to their financial participation in the subsequent investment project.

The existing cooperation agreements as well as the fundamental interest of each of these countries to diversify their commercial partners, to attract new investments and technologies, and to boost their economies, should however help the project to overcome these potential problems and to achieve lasting results.

3.5. Crosscutting Issues

By triggering technical and political dialogue between the four countries of the region and preparing the ground for an important international initiative, which will increase security of energy supply, the project will provide a significant contribution to the construction of an integrated energy market and of a stable economic space in the region. It will therefore assist them in consolidating their regional links, which are indispensable to allow them to adopt a sustainable development path. Due attention to environmental impacts and consultation of local stakeholders, particularly where mitigation issues would have to be addressed, will be an integral part of the project scope. This process should add to its prospects for sustainability, while stimulating the introduction of good governance practices when it comes to dealing with citizens.

In the specific case of this project, gender is not a crosscutting issue to be addressed.

4. IMPLEMENTATION ISSUES

4.1. Implementation method

Centralised management. Close cooperation with the participating governments will be maintained throughout the project's implementation, in close collaboration with the EC Delegations concerned.

4.2. Procurement procedures

All contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

4.3. Budget and calendar

The maximum budget foreseen for this project is 5 M €. The technical assistance will be made available through one or several services contracts, following a tender procedure. Implementation is expected to start at the beginning of 2009 and will last for 3 years in principle.

4.4. Performance monitoring

Project performance and achievements will be monitored by Commission headquarters, in collaboration with the Delegations and the Partner Countries involved in its implementation. The setting up of a Project Working Group will be proposed by the EC to these countries to review and discuss the findings and proposals of the technical assistance team, and to carry out joint project activities whenever possible. Contracted consultants will also ensure regular project monitoring, as is done for ENPI/DCI operations carried out at the regional level.

Key indicators² measuring progress will include, inter alia: the production of studies and reports on specific issues, such as CNG options, risk analyses, technical and legal reviews, draft business plans and EIAs; practical advances in the negotiations with national authorities and gas companies and formal expression of their support; draft proposals regarding the status, composition, organisation and mandate of the Common Commercial Operator; preparation of a draft Inter-Governmental Agreement; production of a list of potential investors and confirmation of the support to the project expressed by IFIs, other potential co-financiers, and insurance companies; and some detailed engineering studies prepared, should the occasion arise.

4.5. Evaluation and audit

Expenditure incurred will have to be certified, as part of the obligations of the contracted parties in the framework of the implementation of this project. Evaluation of the results achieved will be entrusted to independent consultants, as well as external audits (which will be carried out if necessary). These evaluations and audits will be funded from other sources than the project budget, since no commitment will be possible once the validity of this Decision has expired ("N+1" rule will apply).

4.6. Communication and visibility

The project will contribute to, and take advantage of, the actions initiated in 2007 by the INOGATE Technical Secretariat to improve information on this regional programme and more generally, on energy-related issues in the region. A re-vamping of the web portal and the publication of a newsletter, prepared jointly with INOGATE Country Coordinators, are in particular, currently under discussion.

Information on progress of this specific project will be made available regularly to the Commission, the beneficiary countries involved, and the EU Member States. Outside these circles, however, it is anticipated that communication will be limited to the strict minimum in order to avoid creating difficulties to Commission's interlocutors in their relationships with Russia and to reduce the ability of this country to design targeted counteracting measures.

² There are not any DAC standard indicators that would be relevant for this particular project.