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EUROPEANISATION OF THE SOUTHERN GAS CORRIDOR

ASSESSING THE INSTITUTIONAL DIMENSION OF EU ENERGY SECURITY

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ABSTRACT

This PhD offers an original assessment of the EU policies aimed at developing the institutional structures of the Southern Gas Corridor (SGC), focusing in particular on the attempted Europeanisation of energy governance in the SGC countries: Turkey, Georgia and Azerbaijan.

Underpinned by Rational-Choice Institutionalism and its mid-range adaption – the External Incentive Model – the PhD rests on two levels of analyses: one describing EU ambitions in this policy domain and the other assessing the empirical success of those 'Europeanising' ambitions.

At the first level, the PhD describes the ways in which the EU aims to liberalise access to the transit pipelines along the SGC in line with its own preferences. This means subjecting natural gas supply via the SGC to ostensibly "depoliticised" free-market dynamics, as opposed to political bargaining among the various state and non-state actors. In other words, EU policy endeavours to create a regulatory buffer zone in the EU neighbourhood, which would ensure "domestic level" safety in external energy supply. In tying third countries to the rules of its own making, the EU seeks to institutionalise its soft power vis-à-vis others, enabling it to influence the behaviour of actors without the coercive use of military and/or economic means.

At the second level of analysis, the PhD argues that such endeavours have been largely unsuccessful. In the absence of EU membership prospects or membership aspirations, the net domestic adoption costs in the target SGC countries explain the failure of the Europeanisation strategy in Turkey, Georgia and Azerbaijan. These domestic costs stem from the SGC countries' rational national interest in controlling the supply and transit of natural gas from, to and across their sovereign territories in order to further national strategic and/or economic ends. Such interests are intrinsically incompatible with the EU's conception of competitive and depoliticised energy supply and transit.

Consequently, the PhD demonstrates that the SGC will continue to be influenced by the geopolitical and (geo)economic motivations/interests of the transit states concerned, which will render the EU supply of natural gas via this corridor uncompetitive and politicised; and from the EU perspective, potentially insecure.

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LIST OF ACRONYMS

AA - Association Agreement

ACG - Azeri-Chirag-Guneshli oil and gas fields

AIOC - Azerbaijan International Oil Company

AKP - Justice and Development Party of Turkey

BCM - Billion Cubic Metres

BOTAS - Turkish Pipeline Transportation Company

BTC - Baku-Tbilisi-Ceyhan (oil) pipeline

CAPEX - Capital Expenditures

CB - Caspian Basin

CDC - Caspian Development Corporation

CEEC - Central and East European Countries

DCFTA - Deep and Comprehensive Free Trade Agreement

DESFA - Greek Natural Gas Transmission Company

DG - Directorate-Generale

E/E - Entry/Exit System

EaP - Eastern Partnership

EC - European Commission

ECJ - European Court of Justice

ECT - Energy Charter Treaty

EEAS - European External Action Service

EIB - European Investment Bank

EIM - External Incentive Model

EMRA - Turkish Energy Market Regulatory Authority

EnCT - Energy Community Treaty

ENP - European Neighbourhood Policy

EU - European Union

Euroatom (EAEC) - European Atomic Energy Community

GGTC - Georgian Gas Transportation Company

GNEWRC - Georgian National Energy and Water Supply Regulatory Commission

GOGC - Georgian Oil and Gas Corporation

GTM - Gas Target Model

GTS - Gas Transmission System

HGA - Host Government Agreement

IAP - Ionic-Adriatic Pipeline

IEA - International Energy Agency

IEE Programme - Intelligent Energy Europe Programme

IGA - Intergovernmental Agreement

IGB - Interconnector Greece-Bulgaria

INOGATE - **IN**terstate **O**il and **GA**s **T**ransportation to **E**urope

IOCs - International Oil Corporations

ISO - Independent System Operation

ITG - Interconnector Turkey-Greece

ITGI - Interconnector Turkey-Greece-Italy

ITO - Independent Transmission Operator

KRG - Kurdish Regional Government

LDM - Lesson Drawing Model

LNG - Liquefied Natural Gas

ME - Middle East

MFA - Ministry of Foreign Affairs

MoU - Memorandum of Understanding

NGML - Natural Gas Market Law

NW - Nabucco West

OPEX - Operational Expenditures

OU - Ownership Unbundling

PCA - Partnership and Cooperation Agreement

PCI - Projects of Common Interest

PfM - Partnership for Modernisation

PSA - Production Sharing Agreements

RCI - Rational-Choice Institutionalism

RES - Renewable Energy Sources

SCP - South Caucasus Pipeline

SCPC - South Caucasus Pipeline Company

SCPx - South Caucasus Pipeline expansion

SD - Shah Deniz natural gas field

SGC - Southern Gas Corridor

SGG - SOCAR Georgia Gas

SI - Sociological Institutionalism

SLM - Social Learning Model

SOCAR - State Oil Company of Azerbaijan Republic

TANAP - Trans-Anatolian Pipeline

TAP - Trans-Adriatic Pipeline

TCP - Trans-Caspian Pipeline

TEIAŞ - Turkish Electricity Transmission Company

TEP - Third Energy Package

TFEU - Treaty on the Functioning of the European Union

TPA - Third Party Access

TPAO - Turkish State Petrol Pompany

TPIC - Turkish Petroleum International Company

TSO - Transmission System Operator

VIU - Vertically Integrated Undertaking

VTP - Virtual Trading Point

INTRODUCTION

The idea of developing a new European Union (EU) natural gas supply corridor towards the Caspian Basin (CB) and the Middle East (ME) dates back as far as the late 1990s, born from the necessity of providing for the rising energy demand in the EU and the availability of alternative natural gas reserves in these regions. The predecessor to the idea was the oil supply corridor from Azerbaijan to the Turkish Mediterranean port of Ceyhan. The latter, since 2005, has supplied Caspian oil to the world markets and paved the way for the development of the further critical infrastructure to evacuate other hydrocarbon resources from this landlocked region.

The Caspian Basin-EU strategic energy partnership again shot to the top of the agenda in energy policy circles in the middle of the first decade of the current century. This followed the successive Russian gas supply cut-offs to the EU across Ukraine and its (geo)political and (geo)economical repercussions on the EU-Russia bilateral and multilateral relations. The, so called, Southern Gas Corridor (SGC) of the EU consequently emerged as a new favourite topic in policy and scholarly discussions, which envisages connecting the EU to the natural gas reserves in Azerbaijan and Turkmenistan (CB), as well as Iran and Iraq (ME).

As a strategy of diversification of natural gas supplies and transportation routes, the SCG has inspired scholarly research that investigates the potential contribution of the gas reserves in the Caspian Basin and Middle East to ensuring energy security of the EU. This has tended to focus on the reserve potential of these alternative energy basins and their prospective contribution to reducing the economic and political dependence of the EU on the Russian Federation. In this regard, the SGC came to be known as, what one might call, a geopolitical *hardware* strategy; a strategy that concentrates on the development of the necessary infrastructure to diversify EU natural gas supply sources and transportation routes with the aim of changing the balance of power between the EU and Russia.

This was and remains an important research topic in academia. Nevertheless, very little research attention has been devoted to the investigation of energy security risks stemming from the development and future operation of the SGC itself. Nor are the EU's *institutional* policy actions aimed at addressing these risks thoroughly researched. On the latter point, academic literature on the SGC has been lagging behind the literature on EU domestic energy market integration in general, which places enormous emphasis on the development of formal institutions (rules and organisations), or what one might term the

software governing the single EU natural gas market. Especially following the adoption of the so called EU Third Energy Package in 2009, the Union's *institutional* approach to addressing energy security risks (by *liberalising* and *depoliticising* the energy markets within the EU borders) has gained substantial scholarly interest and has been extensively investigated by the academic literature.[1] In contrast, no comprehensive research has been undertaken to investigate the institutional aspects - the *regulatory regime* (or software) that is to govern the EU natural gas supply via the SGC[2] and its potential contribution to the EU's conception of energy security.

This gap in the academic literature is notable given the existence of numerous EU policy initiatives, which aim at the *institutionalisation* of energy supply via the SGC under the EU natural gas market model; in short, the *Europeanisation*[3] of the SGC. The idea of Europeanisation of the SGC is an especially strategic objective for the EU given that different gas volumes to be supplied via this corridor from different sources will have to travel more than 3000 km and will potentially be subject to a variety of *transit risks* of (geo)political and (geo)economic nature before reaching the EU borders. In this respect, this alternative energy corridor risks producing new challenges to the EU energy security, similar to the ones it was originally conceived to resolve vis-à-vis the old energy supply partners.

In this regard, although the EU lacks formal competences in market regulation beyond its borders, (external) Europeanisation constitutes its preferred approach to tackling energy security risks along the SGC. In its relevant policy documents, the EU has specifically pointed out that, transit issues along the SGC have to be resolved in line with the principles

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1 See e.g. Jonathan Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalisation* (London: Chatham House, 2002); Jonathan Stern and Howard Rogers, 'The Transition to Hub-Based Gas Pricing in Continental Europe', *Oxford Institute for Energy Studies*, 2011; Katja Yafimava, *The EU Third Package for Gas and the Gas Target Model* (Oxford: Oxford Institute for Energy Studies, 2013); David Buchan, *Energy and Climate Change: Europe at the Crossroads* (Oxford: Oxford Institute for Energy Studies, 2009); Miguel Vazquez, Michelle Hallack and Jean-Michel Glachant, 'Designing the European Gas Market: More Liquid; Less Natural?', *Economics of Energy & Environmental Policy*, 1.3 (2012); Aad Correljé, Martijn Groenleer and Jasper Veldman, *Understanding Institutional Change: The Development of Institutions for the Regulation of Natural Gas Transportation Systems in the US and the EU*, Robert Schuman Centre for Advanced Studies Loyola de Palacio Programme on Energy Policy (European University Institute/ Florence School of Regulation, 2013).

2 Here the research focus is on institutional (regulatory) aspects of the non-EU segments of the SGC, which include the territories of Azerbaijan, Georgia and Turkey.

3 Here *Europeanisation* is in the meaning of *"the influence of EU policies and values on the 'rest of the world', i.e. non-member states."* In fact the term "*EU*"-isation would be a more accurate word to use. However, I will go along with the widely used term *Europeanisation*. See e.g. Adrienne Heritier, 'Europeanization Research East and West: A Comparative Assessment', in *The Europeanization of Central and Eastern Europe*, ed. by Frank Schimmelfennig and Ulrich Sedelmeier, Cornell Studies in Political Economy (Ithaca, NY: Cornell University Press, 2005), pp. 199–209 (p. 200).

of the EU *acquis*[4] (accumulated legislation, which constitute the body of the EU law), which the Union aims to export to the SGC countries.

In this context, the gap in academic literature on the SGC manifests itself in several ways. Firstly, there is a lack of systematic investigation of the Europeanisation of the SGC; especially missing is thorough analysis of the energy related rule expansion and enforcement mechanisms under the EU's latest external Europeanisation tool - the Eastern Partnership (EaP), which is the sub-dimension of the European Neighbourhood Policy (ENP) focusing on Eastern European countries. Secondly, the existing literature does not provide detailed empirical analysis of how the EU energy (natural gas) *acquis* could potentially address energy security risks along the SGC. Finally, there is very limited systematic academic research on the factors that condition the success and/or failure of the EU external energy governance (external Europeanisation) in the context of the SGC within the disciplines of International Relations and EU studies.[5]

Against this backdrop, instead of putting the *geopolitical* rationale of bringing Caspian and Middle Eastern natural gas to the EU at the centre of analysis, this research takes the implementation of the EU-sourced *formal institutions* (rules and organisations) in the SGC countries as the main focus of investigation and assesses their potential contribution to the EU's conception of energy security. Having all these important issues in mind, this thesis aims to answer the following research questions:

I. ***What is the main political-economic rationale behind the EU policy of Europeanisation towards the institutional governance of the SGC?***

II. ***What factors condition the success/failure of the EU efforts to Europeanise the SGC?***

In investigating the first research question this PhD argues that, the EU's conception of energy security equates this with the *diversity* of energy supplies under *competitive* market conditions – that is to say, not affected by the factors unrelated to the supply and demand balance in the market. In this regard, although as a new, alternative energy corridor the SGC will bring *diversity* to the EU energy market(s), the emergence of *transit* risks along the SGC undermines the *competitiveness* of energy supply via this very energy corridor. Underpinned by the territorial sovereignty, non-EU transit states of the SGC

[4] 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781' (European Commission, 2008), p. 2; 'European Council Presidency Conclusions, 7224/1/07' (The Council, 2007), p. 16; 'The EU Energy Policy: Engaging with Partners beyond Our Borders, COM(2011) 539' (European Commission, 2011), p. 7.

[5] It is important to point out that External Europeanisation is fairly mainstream in the study of the EU external relations. The uniqueness of this research is rather its investigation in relation to the EU external energy policy actions vis-à-vis the SGC and not to the EU external policies in general.

(Turkey, Georgia and Azerbaijan) have the ability to control, interfere with or even facilitate the flow of energy resources that cross their territories in order to realise national (geo)economic and/or (geo)political ends.

In this context, I empirically argue that, the Europeanisation of the institutional (regulatory) governance of the SGC is aimed at the liberalisation of access to the transit pipelines along the SGC under the EU model. This would make natural gas supply via the SGC subject to free-market dynamics, as opposed to political bargaining among the state and non-state actors[6] involved. Indeed, by deploying the EU internal market rules (*acquis*) externally, the Europeanisation of the SGC would reduce strategic and commercial *uncertainty* in the behaviour of the state and non-state actors in influencing the energy supply and transit. Consequently, market-based energy provision would facilitate the depoliticisation of energy supply, while ensuring that the latter is not used as a political tool in international interaction between the EU and the new energy partners along the SGC. In this context, although the EU has repeatedly justified its *market approach* to securing external energy supplies in terms of its efficiency, I contend that this bears certain *geopolitical* implications on the target countries. These geopolitical implications differ in *modus operandi* when compared to the strategies of other international actors; especially Russia, who has been using energy as a *physical* tool of power politics in a classical realpolitik. In contrast, the EU has been successful in dressing its external energy policies, as one expert put it *"in the finer cloaks of rules-based discourse"*.[7]

In practice, however, through the spread of the domestic practices and policies beyond the borders, the EU external governance would lead to the emergence of a regulatory *buffer zone* in the EU neighbourhood, which ensures "*domestic level*" of safety in external energy supply; at times without the hassles of an enlarged membership structure. In practice, the emergence of this *buffer zone* has the capacity to change the balance of *power* in energy security *asymmetrically* in favour of the EU. This would be underpinned by the ability of the EU to influence the behaviour of the actors beyond its border by gaining *institutionalised soft power*[8], for the rules the latter would be bound with are made in the

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[6] E.g. supply and transportation companies.

[7] Richard Youngs, *Europe's External Energy Policy: Between Geopolitics and the Market* (Brussels: CEPS, Centre for European Policy Studies, 2007), p. 8; Andrey Konoplyanik, 'A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)', *Journal of Energy and Natural Resources Law*, 27.2 (2009), 258–91.

[8] Here, the difference between *institutionalised soft power* and conventional *soft power* is that, while the latter is underpinned by the ideational influence over the third counties through the promulgation of one's informal ways-of-doing-things, the former uses formal rules to tie the behaviour of third countries to one's domestic preferences. Essentially, difference is between "*getting others to want what you want"* and *getting others contractually signed up to what you want* without resorting to material means of coercion, such as economic or military might. For *soft power* in a conventional sense, see Joseph S Nye, *The Paradox of American Power: Why the World's Only Superpower Can't Go It Alone* (Oxford: Oxford University Press, 2002), pp. 8–12.

EU. Ultimately, this would limit the capacity of the SGC countries to use energy supply/transit as a tool of their strategic policy-making; hence, diminishing their relative national power vis-à-vis the EU.

Having set this descriptive terrain, this thesis then aims to provide explanatory analysis of the factors that impact upon the success/failure of the Europeanisation of the SGC and then link it to the prospects of EU natural gas supply under *competitive*, *depoliticised* market conditions via this alternative energy corridor. In doing so, I argue that, *in the absence of the EU membership prospects or the lack of membership aspirations, the net domestic adoption costs in the target SGC countries inhibit their energy Europeanisation. Since these domestic costs stem from the SGC countries' rational national interests to control the supply and transit of natural gas to and across their sovereign territories in order to further national strategic and economic ends, they are intrinsically incompatible with the EU's conception of competitive, hence, depoliticised energy supply and transit.* Consequently, the SGC will continue to be influenced by the (geo)political and (geo)economic motivations/interests of the transit states concerned, which will render the EU supply of natural gas via this corridor *uncompetitive* and *politicised* – not subject to the free-market dynamics as envisaged by the EU's notion of energy security.

Of course, with or without EU-sourced institutional reforms of the SGC, the supply of any new natural gas volumes via this corridor will bring diversity to the current EU natural gas market(s) in general terms. This will be an improvement over the pre-existing situation - supply vulnerability stemming from high dependence on Russian gas. As is the old rule in energy supply, it is always better to have two problematic suppliers (Russia and SGC) than one. Hence, the analysis of the Europeanisation of the SGC must not lose sight of these, so called, *hardware* aspects when analysing the future contribution of the SGC to the EU energy security.

In this regard, although the investigation of the formal institutions (*regulatory dimension*) along the SGC is at the core of this PhD, the analysis of the *hardware dimension* of the SGC also provides an important contribution to the literature on energy security. The latter is especially the case, given that the current research has taken place during the period of political and commercial negotiations on the establishment of the SGC. Therefore, it provides an up-to-date and timely discussion on the design of this energy corridor and its contribution to the diversity of the EU natural gas supply in quantitative terms. Additionally, such an analysis is also vital due to the particularity of supply of natural gas as a primary source of energy. In contrast to other fuel types, transportation of natural gas and the very existence of natural gas *market(s)* is heavily dependent on fixed

infrastructure - pipelines. This affects not only the practical flow of energy, but also the application, implementation and consequences of the development of the markets rules in natural gas sector, for the rules get practically expressed in the functioning of the relevant infrastructure. Hence, a separate analysis of the *hardware dimension* of the SGC is important in order to translate the broader abstract assumptions of the institutional elements of this energy corridor into the practical implications.

Chapter outline

With all these in mind, in Chapter I, I first set out the objectives of this thesis and present the main research questions and arguments related to the regulatory (institutional) aspects of the SGC. Secondly, I define the EU's conception of *energy security*, which underpins the institutional policy initiatives undertaken by the EU with regard to this alternative energy corridor. Then, I continue to analyse the institutional dimension of the SGC as an EU external energy policy in conceptual terms. The latter locates the focus of this research within practices of EU external governance that envisage the Europeanisation of non-EU countries. Thirdly, I review extant relevant literature on the SGC and identify in greater detail the above-mentioned gap in this prevailing literature, which this PhD will address. Fourthly, I assess the explanatory arguments of realist and liberal approaches in relation to the SGC and present Rational-Choice Institutionalism (RCI) and its first-order adaption External Incentive Model (EIM) as my preferred theoretical framework for this thesis, as they better engage with the main research questions. Finally, I outline the research design and methods, which I employ in order to achieve the objectives of this thesis.

Chapter II empirically presents the SGC in infrastructure (hardware) terms and provides an historical overview of the development of this alternative energy corridor. There I describe how, following almost a decade of negotiations, the hardware dimension of the SGC is crystallising. With the necessary agreements in place, the SGC has entered the final home stretch with modest but qualitatively new gas volumes from Azerbaijan slated for the EU markets in 2020 via a combination of the South Caucasus Pipeline expansion (SCPx), Trans-Anatolian Pipeline (TANAP), Trans-Adriatic Pipeline (TAP) and Interconnector-Greece-Bulgaria (IGB). These volumes will help to ease the dependence of Southern and South-eastern European countries on Russian gas, while increasing their security of supply.

As such, the analysis of the hardware dimension of the SGC also provides an important contribution to the literature on energy security, for the current research has taken place during the period of political and commercial negotiations on the establishment of the

SGC. Therefore, it provides an up-to-date and timely discussion on the design of the energy corridor in tangible terms.

Nonetheless, the main emphasis of this thesis is that, while the establishment of the necessary infrastructure along the SGC will contribute to the *diversity* of energy supply to the EU, further measures are required to ensure the elimination of the transit risks along the corridor. These regulatory measures are outlined and analysed in Chapter III. The main aim of this chapter is to present a detailed analysis of the EU external energy governance vis-à-vis the SGC and investigate the major EU policy initiatives that are designed to that end. In doing so, Chapter III argues that, the *regulatory dimension* of the SGC is aimed at depoliticising the access to new gas sources and transit capacity along this very new energy corridor by promoting regulated gas market governance therein. It includes measures geared towards reducing non-market risks by shifting energy supply from bilateral political domain onto the multilateral market domain. If successful, this dimension would create the institutional milieu through which the EU could pursue its energy interests in a preferred – free-market setting.

Chapter III indicates that, the emergence of transit risks along the SGC could affect the future natural gas supply not only from Azerbaijan, but also from Iraq, Iran and Turkmenistan. Therefore, the elimination of these risks across Turkey, Georgia and Azerbaijan (non-EU transit segments) is, from the EU perspective, a priority.

In this context, Chapter III contends that, the regulatory dimension of the SGC cannot be called a *foreign energy diplomacy* of the EU in a traditional foreign policy sense. The EU is not a *state* and its external action capacity in energy is limited to the scope of the integration of energy policy domestically. In other words, the EU policies targeting the regulatory dimension of the SGC are only the reflection of the *internal* Europeanisation *externally*. This lack of EU competences in foreign energy policy, however, should not be pre-judged against the potential utility of the EU external energy governance vis-à-vis the SGC. Indeed, successful implementation of the EU *acquis* externally has the potential to alter the international environment that the Union interacts with, by reducing (geo)political and (geo)economic uncertainty for transit of natural gas along the SGC route. Hence, in the absence of the classical *actorness* of the EU in international relations, the lack of conventional capacity for *external* action is being potentially compensated by absorbing the *external* into the *internal* in institutional terms.[9] Accordingly, Chapter III argues that, the EU external energy governance entails power implications, for if

[9] For original conceptual discussions on this matter, see Michael Smith, 'The European Union and a Changing Europe: Establishing the Boundaries of Order', *Journal of Common Market Studies*, 34.1 (1996), 5–28.

successful, it will limit the capacity of the SGC countries to use energy supply/transit as a tool of their strategic policy-making, consequently diminishing their relative national power vis-à-vis the EU.

Within this broader goal, Chapter III also investigates the specific elements in the EU energy legislation that is most relevant to eliminating transit and market access risks along the SGC. These elements will serve as benchmarks for comparatively describing the success or the failure of the EU's external energy governance in Chapters IV, V and VI (in other words, whether the SGC countries and natural gas infrastructure projects are in compliance with the EU *acquis* or not).

In Chapters IV, V and VI, I concentrate on the empirical analysis of the regulatory dimension of the SGC in three key SGC transit countries, namely, Turkey, Georgia and Azerbaijan and argue that, multiple *domestic adoption costs* have so far prevented the Europeanisation of the natural gas sectors in these countries. These costs present a pattern but are not identical in all three countries. In Chapter IV, I investigate the Europeanisation of Turkey's natural gas legislation in the context of the country's EU accession negotiations, highlighting that the transposition and implementation of the EU energy *acquis* have not taken place. Several factors are noted to have played an inhibitive role in this regard. Despite Turkey's decade-long candidate status, the achievement of the final reward (EU membership) is still uncertain, which diminishes the motivation of the Turkish government to adopt EU natural gas legislation. Nevertheless, this uncertainty with regard to eventual EU membership only partially explains this state of affairs, as the application of the general EU energy *acquis* to Turkey has been selective rather than non-existent.

The Turkish government has been keen to capitalise on the EU experience in certain areas of energy policy (especially, renewable energy, electricity sector and in terms of energy efficiency), but reluctant in others (natural gas). This reluctance is assessed through an evaluation of the net domestic costs that Turkey would incur in adopting the EU natural gas legislation without receiving credible and foreseeable membership prospects in return. Turkey is not only a net gas consumer, but also a key transit country between the Caspian Basin/Middle Eastern gas reserves and the EU markets. It presents the only commercially and politically viable corridor for the evacuation of these gas reserves to the EU using pipeline transportation. Therefore, it is argued that political control over the main transit lines contributes to the political and economic muscles of the Turkish government and plays a central role in Turkey's (geo)economic and (geo)political strategy. The institutionalisation of Turkish natural gas sector in accordance with the EU

template, therefore, would diminish the ability of the Turkish government to a) secure ample and cheap gas supplies for its domestic consumers and b) capitalise on its strategic geographical location when pursuing (geo)political goals both vis-à-vis the EU and other regional countries.

Thus, it is argued that in this area at least, the Turkish government seems to be paying only lip service to harmonising its domestic policies with that of the EU and ensuring freedom of gas transit across its territory in a liberalised and depoliticised manner. In reality, however, the government is keen on holding onto its formal capacity to exert control over the transit of gas across its sovereign territory and thereby, influencing regional (and continental) energy supply and geopolitics.

This state of affairs potentially endangers the freedom gas transit and overall gas supply potential of this alternative corridor. Transit hurdles across Turkey will still have to be addressed at the political level (as opposed to under market governance) if additional gas volumes from Iraq, Turkmenistan, Iran (whenever politically feasible) and Azerbaijan are to be supplied to the EU in the future. This, consequently, renders the EU strategy to depoliticise its energy supply corridors unsuccessful and leaves gas supply via the Turkish segment of SGC vulnerable to the conflicting political and economic interests of the Turkish government.

In Chapters V and VI, I investigate the regulatory dimension of the SGC in relation to Georgia and Azerbaijan in the context of their further integration with the EU under the Eastern Partnership. Georgia is legally (contractually) committed to approximate its domestic legislation with the EU *acquis* as part of the signature of the EU-Georgia Association Agreement (AA). The same commitment is also expected to be undertaken by the Georgian government when/if it joins the Energy Community Treaty (EnCT) following the on-going accession negotiations. Georgia pursues EU membership aspirations and is keen on signing up for a closer partnership with the EU, which it is hoped, will improve its EU membership prospects in the long-term. However, in the short-to-medium term Georgia is concerned about the impact of its adoption of the EU *acquis* on the transit benefits and cheap domestic gas that it currently receives from Azerbaijan. This situation is exacerbated by the fact that Georgia is not directly linked to the single EU market and cannot engage in liberalised energy trade from the Union. Therefore, in order to minimise the economic and energy security costs of rule adoption in the absence of membership prospects under the EaP, the Georgian government intends to balance the depth and timeline of its adoption of the EU *acquis* against its needs to receive these benefits.

Unlike Georgia, Azerbaijan, examined in Chapter VI of this thesis, has not undertaken to transpose EU *acquis* domestically. Moreover, rule adoption in the natural gas sector has not taken place as part of the non-binding EU programmes that Azerbaijan has been participating during the past decade. While the absence of EU membership aspirations coupled with its stronger bargaining position vis-à-vis the EU, due to its supplier status, can be considered as factors underpinning the failure of rule adoption by Azerbaijan, I argue that they do not necessarily constitute decisive reasons. More significant are the domestic and strategic (opportunity) costs that the approximation of the Azeri domestic legislation to the EU *acquis* would entail. The adoption of the EU *acquis* would decrease the energy revenues of Azeri government by opening up the domestic gas market to competition. In addition, it would incur opportunity costs by facilitating the freedom of transit of Central Asian gas to the European markets via Azerbaijani territory and transit lines, which would eventually compete against Azeri gas in the EU and Turkish markets in a way that may not be favourable to the country's commercial and (geo)political interests.

Chapters IV, V and VI reveal that, the Europeanisation of the key transit countries along the SGC has failed so far, for reasons related primarily to net adoption costs by the target countries. In the absence of the adequate rewards from the EU, the implementation of external EU governance preferences would incur sizeable costs that are not justified by the potential benefits. As a result, each non-EU segment of the SGC will be governed by the transit and market access rules established by the relevant regional actors, which do not necessarily share similar transit and supply interests with the EU. This will allow them to tailor the access of third-party gas producers, especially from Central Asia and the Middle East, to the European markets to their own commercial and (geo)political interests.

The Southern Gas Corridor is currently slated to bring 10 bcm/a gas to the EU from the year 2020. These volumes could be tripled or even quadrupled if other potential regional suppliers, such as Iran, Iraq and Turkmenistan were linked to the SGC. Failure of Europeanisation of Azerbaijan, Georgia and Turkey, however, is likely to hamper these prospects. Indeed, I argue that the future potential of the SGC remains uncertain, as the regulatory hurdles may well create capacity bottlenecks for the Central Asian and Middle Eastern gas suppliers. This will also negatively affect the competitiveness of the EU natural gas supply via the SGC.

Contribution

By investigating the SGC in a two-dimensional policy framework (*hardware* and *regulatory*), the contribution of this PhD transcends the boundaries of any single subject domain. Firstly, it contributes to Security Studies/International Relations and in

particular, work on energy security. With its special emphasis on the role of *formal institutions* in dealing with challenges to energy supply in a *strategic context*, it presents an important *empirical* contribution to bridging the diverging positions of the Liberal and Realist approaches to energy security in Security Studies domain.

The thesis also makes an important contribution to EU Studies, particularly work on external relations and Europeanisation. This is especially relevant in relation to the EU Eastern Partnership strategy, which as a young policy framework has yet to be comprehensively researched in an academic setting. Therefore, by investigating the establishment of the formal institutions in the natural gas sectors of Azerbaijan and Georgia, the two of the six EaP countries, this thesis does not limit itself with the analysis of energy security alone. It also provides a first-hand empirical analysis of the EU's new external policy tool, which seeks the extension of the EU's regulatory space over the ENP countries without providing EU membership prospects.

This PhD also provides a substantial empirical contribution to the literature on the EU international relations. In this view, the significance of this thesis is in its investigation of the inter-relations between the scope of the EU internal energy policy and the EU external policy action in natural gas sector. In support of the existing theoretical literature,[10] hence, this PhD brings together the *internal* and *external* aspects of the EU's International Relations and provides first-hand empirical investigation on the factors that affect the success and failure of the EU external policy actions.

Finally, by providing comprehensive factual analysis of each of the individual policy strands pursued by the EU in relation to the SGC, the thesis contributes to the empirical knowledge in the growing literature on the EU energy security in particular. This is especially relevant given the fact that a big number of milestone events related to the SGC took place during the accomplishment of this PhD. Therefore, the research can serve as a source of information for a potential secondary analysis of the EU energy security in the future.

[10] Christopher Hill, *The Changing Politics of Foreign Policy* (Houndmills, Basingstoke, Hampshire ; New York: Palgrave Macmillan, 2003); Michael E. Smith, 'Institutionalization, Policy Adaptation and European Foreign Policy Cooperation', *European Journal of International Relations*, 10.1 (2004), 95–136.

CHAPTER I: FOCUS, OBJECTIVES AND THE THEORETICAL FRAMEWORK OF THE RESEARCH

1. Introduction

Energy security is one of the most significant and seemingly daunting problems of modern societies. Energy security is problematic not simply because it is the backbone of everyday human activities, but because it is plagued by different interpretations and implications of the major concepts (energy as a strategic vs. ordinary commodity) and definitions (producers' vs. consumers' definition of energy security) throughout the spectrum of energy politics. These differences in opinion create problems for researchers and policymakers alike and are often aggravated by the contentions on the nature of the problem, that is to say, the disagreements about the *real* problems on the ground as opposed to the *perceptions* thereof. As if these were not enough, *time* brings forth a new dimension for complication, where differences in opinion vary and evolve throughout the timespan producing new concerns that previously were not part of the political strategies.

Against the backdrop of these uncertainties and plurality of opinion, the main aim of this thesis is the assessment of the regulatory aspects of the Southern Gas Corridor strategy of the EU, which aims to ensure the energy security[11] of the EU member states by diversifying energy supply towards massive and yet largely untapped natural gas reserves of the Caspian Basin and the Middle East (see ***Fig. 1***). The SGC strategy emerged as one of the top priorities of the EU energy policy following the successive gas cut-offs to the EU in 2006 and 2009, caused by the disputes between the Russian Federation and its main supply transit country Ukraine. Gas reserves in the Caspian and Middle Eastern regions present a unique opportunity for the EU not only in terms of ensuring diversity of energy provision, but also due to the relatively low costs associated with gas production therein. The latter represents a competitive advantage vis-à-vis the Russian gas supplied from Western and Eastern Siberia.[12]

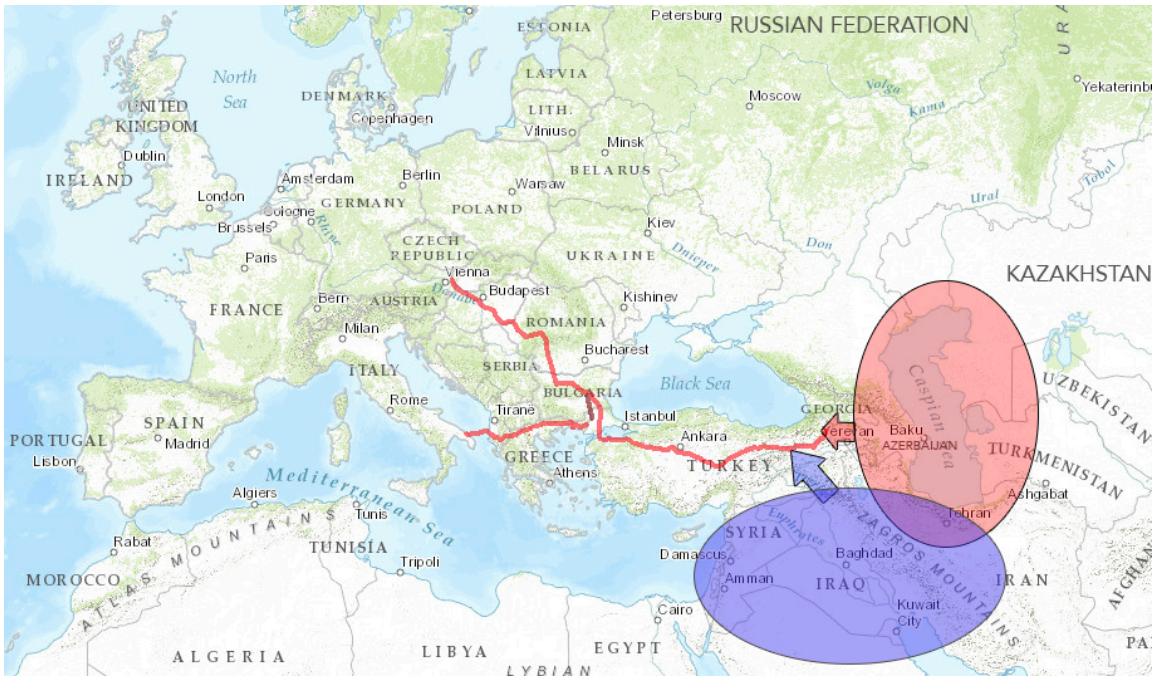
In general terms, the Caspian Basin is a broad geographical area encompassing all the Caspian littoral states, as well as the countries in the South Caucasus and Central Asia,

[11] Although the definition of energy security encompasses all the available sources of energy supply, including oil, gas, coal, nuclear, solar, wind, hydro, bio-energy, etc., in the context of this PhD I will be specifically referring to natural gas security, unless explicitly mentioned otherwise.

[12] Mert Bilgin, 'Geopolitics of European Natural Gas Demand: Supplies from Russia, Caspian and the Middle East', *Energy Policy*, 37.11 (2009), 4482–92 (p. 4485).

which do not have direct access to the Caspian Sea as such. The area includes Armenia, Azerbaijan, Georgia, Iran, Kazakhstan, Russian Federation, Turkmenistan, Tajikistan, Kirgizstan and Uzbekistan. However, when referring to the Caspian Basin natural gas reserves, I will, for the purposes of this thesis, refer specifically to Azerbaijan and Turkmenistan, unless stated otherwise. Both Russia and Iran directly border the Caspian Sea and possess the first and the second largest gas reserves in the world. However, the major geographical areas of energy production for either country are Siberia/Arctic and the Persian Gulf (Middle East), respectively. Therefore, neither is considered as *Caspian* energy producers. Additionally, although Kazakhstan and Uzbekistan possess natural gas reserves, all of the produced natural gas in either country is used for domestic purposes and are not export-oriented. The rest of the Caspian region countries do not possess natural gas resources. Additionally, when referring to the Middle Eastern gas reserve, I will have Iran and Iraq in mind.

Fig. 1: Conceptual map of the Southern Gas Corridor | Created by the author using publically available info.



In this context, this purpose of this chapter is argue that, although the SGC strategy of the EU has attracted a great deal of academic research in the past, the existing literature has largely ignored the *institutional* aspects of the development of this alternative energy corridor, which concerns the role of the market rules and practices in energy supply and transit. By putting the analysis of these issues at the heart of this thesis, I aim to present a

new outlook to the prospective role of the SGC in ensuring the EU energy security and contribute to academic knowledge from the perspective of the EU external governance.

Below, I first describe the research focus and outline the main research questions and the arguments of this thesis. Secondly, I examine the definition of energy supply in the EU context and analyse the institutional aspects of the SGC within the EU external energy policy in conceptual terms. The latter locates the focus of this research within the EU external governance, which envisages the Europeanisation of non-EU countries. Thirdly, I present the literature review on the SGC and demonstrate the contribution of this thesis to addressing the gap in the academic literature. Fourthly, I present Rational Choice Institutionalism (RCI) and its first-order adaptation External Incentive Model (EIM) as my preferred theoretical framework, as they better engage with the research questions of this thesis. Finally, I outline the research design and methods, which I employ in order to achieve the objectives of this thesis.

2. Research focus and objectives

Energy security is not a constant concept, but an evolving and expanding one. If at the beginning of the twentieth century energy security of the European countries was associated with ample and diverse supply of oil (which was imported from abroad) at a reasonable price,[13] this approach changed at the end of the same century. Although today the European countries have a much more diverse energy mix, consisting of both fossil fuels and renewable energy sources (RES), in 2012 34% and 23% of total domestic energy demand was still met by oil and natural gas, respectively. Moreover, 90% of oil and 66% of consumed gas is supplied to the EU by third countries, while indigenous European production is in continuous decline. Against this backdrop and due to the centrality of energy to economic growth, as well as to national security, pursuing strategies to ensure adequate energy supply has come to constitute one of the top priorities of the EU policy-making.

The beginning of the EU's energy policy dates back to the Treaties establishing the European Economic Community in the 1950s. The European Coal and Steel Community, founded by the Treaty of Paris in 1951, was the first step in instituting a common energy policy of the predecessor of the modern EU, but also the very existence of the European Economic Community that was fully established later in 1957 by the Treaty of Rome. The

[13] Daniel Yergin, 'Energy Security and Markets', in *Energy and Security: Toward a New Foreign Policy Strategy*, ed. by Jan H. Kalichi and David L. Goldwyn (Washington, D.C.: Woodrow Wilson Centre Press, 2005), pp. 51–64 (p. 52).

Treaty of Paris envisaged a common policy and control over the coal and steel production, which were the bedrocks of war industries at the time. It later followed by the establishment of the European Atomic Energy Community (EAEC or Euroatom) in 1958. Euroatom was the first common policy in ensuring energy security throughout the Community territory as the switch from coal to oil raised the concerns about the scarcity of oil reserves in the territory of participant states and thereby manifested the necessity of diversifying energy supply mix. It also marked the start of supranational level integration in securing energy supply via creation of common rules governing (nuclear) energy provision and streamlining the policies of individual members.[14]

The Community-wide policy on natural gas, however, did not appear on the Union/Community's daily agenda until after the end of the Cold War, when the *Gas Transit Directive* was adopted in 1991 in order to facilitate the access to gas pipelines in Europe after fall of the Socialist camp. Later, in the mid-1990s the European Court of Justice (ECJ) ruling recognised natural gas a good *"like any other"*, which paved way to the community policy-making on natural gas in the context of the development of internal energy market (IEM).[15] Subsequently, the EU natural gas policy saw the adoption of the *First* (1998), *Second* (2003) and *Third* (2009) Energy Packages, each taking the liberalisation and integration of the natural gas markets of the member states a step further, while at times running ahead of Treaty clauses.[16]

In line with the overarching principles of the EU energy policy - *competitiveness*, *security of supply* and *sustainability*,[17] EU policy on natural gas is aimed at the establishment of a single EU-wide competitive natural gas market, which envisions policy actions at two levels[18]: 1) *hardware* (physical integration of the national markets of the EU member states), and 2) *software* (establishment of rules regulating the single market; in order words the Europeanisation of the natural gas market rules of the member states). As I will further analyse in Chapter III, the latter is aimed at liberalisation and depoliticisation of the supply of energy to the consumers and make it subject to competitive market

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[14] José María Marín Quemada, Carlos Velasco and Beatriz Muñoz, 'Energy Security of Supply and EU Energy Policy', in *Energy Security for the EU in the 21st Century: Markets, Geopolitics and Corridors*, ed. by José María Marín Quemada, Javier García-Verdugo, and Gonzalo Escribano (London; New York: Routledge, 2012), pp. 195–209; Buchan, *Energy and Climate Change: Europe at the Crossroads*, p. 6.

[15] Yafimava, *The EU Third Package for Gas and the Gas Target Model*, p. 2; see also, Buchan, *Energy and Climate Change: Europe at the Crossroads*, p. 9.

[16] Buchan, *Energy and Climate Change: Europe at the Crossroads*, p. 9.

[17] *Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy, COM (2006) 105* (European Commission, 2006); 'European Council Presidency Conclusions, 7224/1/07', p. 11; 'Treaty of Lisbon: Amending the Treaty on European Union and the Treaty Establishing the European Community', *Official Journal of the European Union*, 50.C 306 (2007), Article 176A.

[18] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80* (Brussels: European Commission, 2015), pp. 8–10.

dynamics. Although the establishment of a single market serves as an underlying framework for ensuring the EU natural gas supply security, the latter also necessitates, among others, the diversification of *sources and routes of supply of imported energy.*[19]

In order to facilitate the diversity of energy supplies, it was in its Second Strategic Energy Review (SSER) that the EC identified the establishment of the Southern Gas Corridor (SGC)[20] as an important policy strategy, aimed at sourcing significant amounts of gas from the Caspian Basin and the Middle East (namely, Azerbaijan, Turkmenistan, Uzbekistan, Iran, Iraq and Mashreq countries).[21] The SGC strategy serves as an *external enabler* of the EU's domestic market integration policy,[22] as it is to bring new volumes to the EU markets from previously untapped sources through the establishment of the necessary infrastructure (hardware). These new volumes can reduce supply risks by compensating the decline of the indigenous EU production, bringing about competitive market-based supply security and improving the overall resilience of the system by reducing vulnerability against unexpected supply shocks; including (geo)political challenges stemming from over-reliance on concentrated supply sources. In other words, SGC is to contribute to addressing the pre-existing challenges by diversifying energy supplies and transportation routes.

Nonetheless, the policy objectives promoted by the EU in relation to the SGC is not limited to the physical establishment of the necessary infrastructure to transport new gas volumes to the EU market(s). Mirroring the policies undertaken within the EU borders, the SGC strategy also includes policy actions in relation to the *institutional* (software) aspects of the development of this alternative energy corridor. This is an especially germane issue for the EU given that gas volumes to be supplied via the SGC from different sources will have to travel more than 3000 km and will potentially be subject to a variety of *transit risks* of (geo)political and (geo)economic nature before reaching the EU borders. Although EU lacks formal competences in market regulation beyond its borders, Europeanisation remains its preferred policy tool for tackling non-market risks to energy supply and ensuring *freedom of transit* along the SGC, too. In its relevant policy documents,

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[19] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, pp. 4–5; 'Green Paper - Towards a European Strategy for the Security of Energy Supply, COM (2000) 0769' (European Commission, 2000), p. 2.

[20] Officially, *Southern Corridor* was first mentioned in the Second Strategic Energy Review of the European Commission in 2008. The term later came to refer to the alternative natural gas corridor across Turkey, which is to link EU with the Caspian Basin and Middle Eastern gas reserves; thus evolving into *Southern Gas Corridor* (SGC) in the official EU documents and legislative acts.

[21] 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781', p. 4; *Council Conclusions on 'Second Strategic Energy Review - An EU Energy Security and Solidarity Action Plan'* (Brussels: The Council of the European Union, 2009); *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 4.

[22] *Energy 2020: A Strategy for Competitive, Sustainable and Secure Energy, COM(2010) 639*, 2010, p. 10.

the EU has specifically pointed out that, transit issues along the SGC has to be resolved in line with the principles of the EU *acquis*[23] (accumulated legislation, which constitute the body of the EU law).

In itself, the export of the EU *acquis* presents not only a potential model for the organisation of the non-EU markets in general, but also helps to make up for the lack of state attributes (external energy competencies) of the EU in dealing with non-EU actors at the political level. By expanding EU *acquis* beyond its borders, the EU is aiming to establish a political milieu through which it can pursue its (energy) preferences at the technical-expert level where it enjoys extensive expertise. As the champions of the external governance literature put it, *"[t]he EU is best at expanding governance where it can translate political problems into technocratic ones, and where it can deal with technocrats, bureaucrats and market actors."*[24] In order to facilitate this objective, the Declaration of the Prague Summit on Southern Gas Corridor on May 8, 2009 stated that the SGC concept is a synergy of different policy instruments, inter alia, EU-Azerbaijan, EU-Georgia Partnership and Cooperation Agreements, Association Agreement with Turkey, European Neighbourhood Policy/Eastern Partnership (ENP/EaP), EU-Azerbaijan memorandum of understanding on energy and other bilateral and multilateral documents signed by the EU and relevant third countries.[25] As I will investigate in detail in Chapter III, these policy initiatives aim at integrating the relevant third-countries to the EU markets by harmonising their domestic market rules with that of the EU *acquis* and constitute an external element of the EU energy policy in general.

Indeed, if the alternative gas supplies via the SGC are to play a significant role in ensuring the competitiveness of the EU gas suppliers, then EU-sourced regulatory treatment of the SGC beyond the EU borders is only the logical continuation of the EU's domestic gas market policy.[26] This is especially encouraged by the fact that, unlike other EU pipeline corridors (i.e. Norwegian, Russian, Algerian/Libyan), the SGC will allow the EU to tap into several production basins simultaneously. Thus, the necessity of ensuring free-market governance and reducing transit risks for gas supply along the SGC make it all the more

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[23] See e.g. 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781', p. 4; 'European Council Presidency Conclusions, 7224/1/07', p. 16; 'The EU Energy Policy: Engaging with Partners beyond Our Borders, COM(2011) 539', p. 7.

[24] Glada Lahn, Stephen Padgett and Sandra Lavenex, *External European Union Governance in Energy and the Environment* (Chatham House: Energy, Environment and Development Programme, 16 September 2009), p. 9; see also, Michael Smith, 'Between Two Worlds? The European Union, the United States and World Order', *International Politics*, 41.1 (2004), 95–117.

[25] 'Prague Summit Declarations: Southern Corridor' (Council of the European Union, 2009), p. 2.

[26] Following the proposal by the EC, this was explicitly endorsed by the Council in its conclusions on Second Strategic Energy Review. *Council Conclusions on 'Second Strategic Energy Review - An EU Energy Security and Solidarity Action Plan'*, p. 3.

relevant for the EU to also foster EU *acquis*-based regulation of this alternative energy corridor.

Although, as I demonstrate in the literature review section, EU's efforts to export its energy *acquis* to non-EU countries has been considerably acknowledged by the academic literature,[27] the major and considerably new avenues of this rule extension have so far been under-investigated. Especially lacking is the thorough analysis of the energy related rule expansion and enforcement mechanisms under the latest contractual commitments in relation to Azerbaijan and Georgia within the ENP/EaP policy framework. This is partly conditioned by the fact that, the latter policy instrument is considerably new in the EU's external governance repertoire and its contractual outcome materialised only in 2014. Secondly, the existing literature does not provide detailed empirical analysis of how the EU energy (natural gas) *acquis* can potentially address transit risks along the SGC. Even less so, there is a deficiency of systematic academic research on the factors that condition the success and/or failure of the EU external energy governance in the context of the SGC within the discipline of International Relations and EU studies, where this PhD aims to address the gap in the academic literature. Having all these important issues in mind, this thesis aims to address the following research questions:

I. ***What is the main political-economic rationale behind the EU policy of Europeanisation towards the institutional governance of the SGC?***

II. ***What factors condition the success/failure of the EU efforts to Europeanise the SGC?***

This is not to claim that there is no research on this subject. For example, Bosse,[28] Finon,[29] Escribano Francés[30] make a broad conceptual reference to the potential implications of Europeanisation of energy corridors to the EU energy security, without providing detailed

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[27] See e.g. Youngs, *Europe's External Energy Policy: Between Geopolitics and the Market*; Oscar Pardo Sierra, 'A Corridor through Thorns: EU Energy Security and the Southern Energy Corridor', *European Security*, 19.4 (2010), 643–60; Buchan, *Energy and Climate Change: Europe at the Crossroads*, p. 84; Lahn, Padgett and Lavenex, *External European Union Governance in Energy and the Environment*; Giselle Bosse, 'The EU's Geopolitical Vision of a European Energy Space: When "Gulliver" Meets "White Elephants" and Verdi's Babylonian King', *Geopolitics*, 16.3 (2011), 512–35; Dominique Finon and Catherine Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', *Energy Policy*, 36.1 (2008), 423–42 (p. 427); Gonzalo Escribano Francés, 'Market or Geopolitics? The Europeanization of EU's Energy Corridors', ed. by John Psarras, *International Journal of Energy Sector Management*, 5.1 (2011), 39–59.

[28] Bosse, 'The EU's Geopolitical Vision of a European Energy Space: When "Gulliver" Meets "White Elephants" and Verdi's Babylonian King'; see also Sohbet Karbuz,
'Review of the EU Strategy on Energy towards the Black and Caspian Sea Basins' (presented at the European Union's stress test for its multilateral approach: Prospects for fostering regional cooperation, Tallinn: EU4seas, 2011), p. 8.

[29] Dominique Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', *OPEC Energy Review*, 35.1 (2011), 47–69; Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 427.

[30] Escribano Francés, 'Market or Geopolitics? The Europeanization of EU's Energy Corridors'.

analysis of external governance in natural gas sector in general and the Southern Gas Corridor in particular. Additionally, although the research undertaken by Winrow[31] in relation to the SGC is empirically extensive, it does not present a conceptually and theoretically well-grounded analysis of Europeanisation of the SGC. Furthermore, Winrow concentrates only on the Turkish section of the SGC and does not extend the analysis to the other parts of this alternative energy corridor (Georgia and Azerbaijan).

Furthermore, other scholars, among others, Pardo Sierra have made brave initial steps in analysing the potential factors affecting the Europeanisation of the SGC, where he attributes the failure of the EU external governance towards the SGC to ***external*** (regional) factors and to the ***legitimacy*** concerns of the state actors along the SGC.[32] Studies carried out by Samuel Lussac, on the other hand, lack detailed specific institutional analysis of the EU external governance despite providing valuable primary investigations of the interests of the state and non-state actors along the SGC.[33] Prange-Gstöhl, on the other hand, presents *"demand side"* explanatory factors in explaining why third countries would be interested in adopting the EU rules.[34] However, since his analysis does not evaluate the practical outcome of the adoption of the EU rules, his broader conceptual position remains empirically invalidated. Furthermore, Prange-Gstöhl does not engage with the factors that place constraints on the adoption of the EU natural gas rules by third countries. Thus, as I further demonstrate in the literature review section, there is no comprehensive research that investigates the role of the ***domestic constraints*** in affecting the success of the EU external energy governance in natural gas sector vis-à-vis the SGC.

In order to account for different cross-cutting elements within the SGC strategy and address the main research questions, this thesis presents a two-dimensional structure for analysis of this alternative energy supply corridor:

I. ***Hardware dimension of the SGC*** - on the one hand, is aimed at the development of physical infrastructure in order to reduce the vulnerability of the EU natural gas provision. As such, the practical role of the development of the physical

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31 Gareth M. Winrow, 'Problems and Prospects for the Fourth Corridor: The Positions and Role of Turkey in Gas Transit to Europe', *Oxford Institute for Energy Studies*, NG 30, 2009; Gareth M. Winrow, 'The Southern Gas Corridor and Turkey's Role as an Energy Transit State and Energy Hub', *Insight Turkey*, 2013, 145–63; see also, Saban Kardas, 'Turkish–Azerbaijani Energy Cooperation and Nabucco: Testing the Limits of the New Turkish Foreign Policy Rhetoric', *Turkish Studies*, 12.1 (2011), 55–77.

32 Pardo Sierra, 'A Corridor through Thorns: EU Energy Security and the Southern Energy Corridor'; Oscar Pardo Sierra, 'No Man's Land? A Comparative Analysis of the EU and Russia's Influence in the Southern Caucasus', *Communist and Post-Communist Studies*, 44.3 (2011), 233–43.

33 See e.g. Samuel James Lussac, 'Ensuring European Energy Security in Russian "Near Abroad": The Case of the South Caucasus', *European Security*, 19.4 (2010), 607–25; Samuel James Lussac, *The State as a (Oil) Company? The Political Economy of Azerbaijan*, February 2010.

34 Heiko Prange-Gstöhl, 'Enlarging the EU's Internal Energy Market: Why Would Third Countries Accept EU Rule Export?', *Energy Policy*, 37.12 (2009), 5296–5303.

infrastructure is to diversify supply sources and routes towards the Caspian Basin and the Middle East and accordingly, allow the EU to address pre-existing gas supply risks largely stemming from a high dependence on Russian gas supplies.

II. ***Regulatory dimension of the SGC*** - on the other hand, is aimed at *liberalising* and *depoliticising* the access to new gas sources and transit along the SGC by promoting market governance that ensures competitiveness of gas supply to the EU. This involves shifting energy supply from a bilateral political domain into a multilateral market domain and is to be achieved via the extension of the EU's domestic energy legislation along the entire route of the SGC. In a bigger picture, if the *hardware* dimension of the SGC is to allow the EU to address pre-existing gas supply risks by providing supply and route diversity, *regulatory* dimension of the SGC concept is to help the EU to (also) address supply and transit-related non-market risks stemming from the SGC itself by bolstering depoliticisation along the corridor. Hence, although the development of physical infrastructure is intrinsically linked to the development of formal rules governing them, the two should be investigated separately in order to unearth their contribution to different objectives of the EU's conception of *energy security,* as I will illustrate in the following section.

Having set this structure, this thesis then sets off to provide explanatory analysis of the factors that impact upon the success/failure of the Europeanisation of the SGC and link it to the prospects of EU natural gas supply under *competitive*, *depoliticised* market conditions via this alternative energy corridor. In doing so, I argue that, *in the absence of the EU membership prospects or the lack of membership aspirations, the net domestic adoption costs in the target SGC countries inhibit their energy Europeanisation. Since these domestic costs stem from the SGC countries' rational national interests to control the supply and transit of natural gas to and across their sovereign territories in order to further national strategic and economic ends, they are intrinsically incompatible with the EU's conception of competitive, hence, depoliticised energy supply and transit.* Consequently, the SGC will continue to be influenced by the (geo)political and (geo)economic motivations/interests of the transit states concerned, which will render the EU supply of natural gas via this corridor *uncompetitive* and *politicised* – not subject to the free-market dynamics as envisaged by the EU's notion of energy security.

Since I rely on qualitative methodology, it also allows me to reveal and analyse country specific particularities of general *domestic costs* in individual SGC countries in the relevant empirical chapters. The analysis of inter-relations between EU external energy governance and the domestic constraints in the target countries in a *cause and effect* manner

(domestic adoption costs as a *cause* while the failure of rule adoption as an *effect*) serves as the core contribution of this PhD to academic literature.

Nonetheless, the analysis of the hardware dimension of the SGC also provides an important contribution to the literature on energy security, for the current research has taken place during the period of political and commercial negotiations on the establishment of the SGC. Therefore, it provides up-to-date and timely discussions on the design of the energy corridor and its contribution to the diversity of the EU natural gas supply in quantitative terms. In contrast to other fuel types, the transportation and the very existence of *market(s)* in natural gas is heavily dependent on fixed infrastructure, especially pipelines. This affects not only the practical flow of energy, but also the application, implementation and consequences of development of the markets rules in natural gas sector, for the rules get practically expressed in the functioning of the relevant infrastructure. Hence, in order to translate the broader abstract assumptions of the institutional elements of the SGC into the practical implications, separate analysis of the *hardware dimension* of the SGC is vital.

Such a de-construction of the SGC strategy has high policy relevance, as breaking it down into component parts might enhance the predictability of the official policy-making by bringing attention to the nodes of energy politics, which might otherwise be overlooked if treated in unison. This is also conditioned by the very definition of *energy security* in the EU context, which places great importance both on the *diversity*, as well as the *competitiveness* of energy supplies.

Hence, before reviewing the academic literature on the SGC and defining the theoretical terrain of this thesis, it is also important to assess the definition of the *EU energy security* in order to ensure the coherence of this research, as well to place the research focus into a broad conceptual framework. Since this thesis puts the main emphasis on the efforts of the EU to expand its sphere of influence in regulatory (institutional) terms, it is important to assess the broad rationale of the policy actions taken in relation to non-EU actors and the nature of relations between the EU and the relevant third countries in the context of implementation of these policies. To that end, after assessing the definition of EU energy security, the ensuing sections analyse the EU external governance in relation to the SGC, which aims at Europeanisation of this alternative energy corridor. The purpose here is not to identify individual rules (regulations, directives) that the EU aims to export to the SGC countries (which I accomplish in Chapter III), but to provide a global overview of external governance as a strategy to deal with external risks and challenges.

3. Defining energy security

Security, as an important concept of international relations has traditionally been associated primarily with military security.[35] In the decades following the energy crisis of the early 1970s, the concept has been broadened to include non-military challenges, too. Ullman proposed to define security as a *"sequence of events"* which in a short period of time can *"degrade the quality of life for the inhabitants of a state"* or remarkably *"narrow the range of policy choices available to the government of a state or to private, non-governmental entities (persons, groups, corporations) within the state"*.[36] These incorporate threats, among others, stemming from the *"interruptions in the flow of critically needed resources or, indeed, a dwindling of the available global supply"*.[37] In this respect, like military threats, interruptions in the flow of necessary resources may have a profound negative effect on the quality of life of the population and the general wellbeing of a given society. Consequently, this point necessitates regarding the secure provision of essential resources, *inter alia*, energy resources as a matter of security. However, calling an issue a matter of security, whether economic or military, does not necessarily signal the policies designed to ensure it.

Due to its centrality to the current research, it is important to define the concept of energy security before moving on to investigating the rationale behind the EU's pursuits to establish alternative energy corridor towards the Caspian Basin and the Middle East. Defining energy security will not only explicate the main concept, but also serve as a general benchmark against which I will assess the contribution of the SGC to the EU's energy security needs down the line in this PhD.

In addition to its implications on academic research, the definition of energy security also entails political and economic consequences. In the energy domain effective security counter-measures require costly investments and financial allocations, especially in natural gas industry. In a liberal international economic order, where the principles of efficiency and vulnerability are archenemies, decision-making in costly fund allocations requires rigorous justification of the policy objectives. In this view, the international energy companies that make up much of the fabric of the Western energy system can, especially, be reluctant to invest in contingency measures, such as emergency supply infrastructure, energy storage, etc., which they will not be using for their regular daily

[35] Walter Lippmann, *U. S. Foreign Policy: Shield of the Republic* (Little Brown, 1943), p. 51; Arnold Wolfers, *Discord and Collaboration: Essays on International Politics: Essays in International Politics*, New edition (The Johns Hopkins University Press, 1965), p. 150.

[36] Richard H. Ullman, 'Redefining Security', *International Security*, 8.1 (1983), 129–53 (p. 129).

[37] Ullman, 'Redefining Security', p. 135.

operations, regardless of additional costs incurred.[38] Therefore, the definition of energy security has to offer a sense of common understanding and the predictability for the policies to be pursued, which will subsequently affect the outcome thereof.

In this context, as important as it may be, agreeing on the definition of energy security has been as difficult as agreeing on the policies to ensure it, for it entails different meanings to different actors (from producers to transit and consumer countries) across different time horizons within the international energy system.[39] Furthermore, the perception of energy security differs even across the spectrum of consumer countries, too. For the United States, energy independence and the desire to decrease its oil import dependence is of foremost concern. For other consuming leviathans, especially for China and India energy security is related to the necessity that (lack of) energy does not hamper burgeoning economic growth and entail social consequences.[40] In the EU context, however, energy security has largely (but not exclusively) been associated with over-dependence on gas imports from the Russian Federation. In general, the European Commission argued that, *"Energy supply security must be geared to ensuring [...] the proper functioning of the economy, the uninterrupted physical availability [...] at a price which is affordable. [...] Security of supply does not seek to maximise energy self-sufficiency or to minimise dependence, but aims to reduce the risks linked to such dependence",*[41] although later the EC acknowledged that the risks to uninterrupted energy supply grows as the import dependence increases.[42] In this regard, the EU's interpretation of energy security offers a general idea of the latter's overarching vision of energy security; however, it does not necessarily provide a detailed components thereof, although they are present in the individual policy actions already undertaken to that end. The aim here is, thus, to identify an operational definition of natural gas security in the EU context, which will make it practical to examine the policies designed to resolve the problem.

In general, mainstream academic definitions of energy security of the consumer countries can be categorised in three strands of benchmarks:

- ***Diversity and ampleness,***
- ***Affordability and,***

[38] See e.g. Stern and Rogers, 'The Transition to Hub-Based Gas Pricing in Continental Europe', p. 20.

[39] Paul Isbell, 'Paul Isbell Revisits the Energy Security Debate', *Oxford Energy Forum*, 2007, 3–6; Daniel Yergin, 'What Does "Energy Security" Really Mean?', *Wall Street Journal*, 11 July 2006 <http://online.wsj.com/article/SB115258420318203023.html> [accessed 25 April 2012].

[40] Yergin, 'What Does "Energy Security" Really Mean?'

[41] 'Green Paper - Towards a European Strategy for the Security of Energy Supply, COM (2000) 0769', p. 2.

[42] *Towards a Common European Foreign Policy on Energy, A6-0312/2007* (European Parliament, 2007), p. 1.

- ***Reliability of energy provision.***

Kalichi and Goldwyn suggested that*: "energy security is [...] the provision of affordable, reliable, diverse and ample supplies of oil and gas (and their future equivalents) [...] and adequate infrastructure to deliver these supplies to market".*[43] The International Energy Agency (IEA) similarly noted that, *"Energy security, broadly defined, means adequate, affordable and reliable supplies of energy"*.[44]

Firstly, diversity of energy supply is the most straightforward element of any energy security strategy. The aim of diversity is not to maximise energy self-sufficiency or to minimise import dependency, but to reduce the risks linked to such dependency by increasing the number of energy supply sources, transportation routes and supply counterparts. The practical contribution of diverse energy supplies is the reduction of *energy vulnerability,* which is incurred by the *geographic concentration* of supply sources and the (lack of) flexibility of the relevant infrastructure.[45] By reducing the geographical concentration of energy supply, *diversity* allows to have many suppliers of energy, instead of one, where the relative importance of any of them is not very great.[46] This, on the other hand, allows compensating the shortage of energy from one source by many others. Winston Churchill's historical statement before the WWI - *"safety and certainty in oil lie in variety and variety alone"*[47] - is probably the first historically recorded example of attempting to secure diverse supplies of energy. Accordingly, the level of variety (diversification) has come to constitute an essential principle of the states' sound energy security strategies in modern times.[48]

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[43] Jan H. Kalichi and David L. Goldwyn, 'Introduction: The Need to Integrate Energy and Foreign Policy', in *Energy and Security: Toward a New Foreign Policy Strategy*, ed. by Jan H. Kalichi and David L. Goldwyn (Washington, D.C.: Woodrow Wilson Centre Press, 2005), pp. 1–16 (p. 9).

[44] *World Energy Outlook 2007: China and India Insights.* (Paris: IEA, 2007), p. 160; José Goldemberg, Thomas B Johansson and Dennis Anderson, *World Energy Assessment: Overview* (New York: United Nations Development Programme, Bureau for Development Policy, 2004), p. 42; for similar definitions, see also Douglas R. Bohi and Michael A. Toman, *The Economics of Energy Security* (Boston: Springer, 1996); *Energy Security: Managing Risk in a Dynamic Legal and Regulatory Environment*, ed. by Barry Barton and others (Oxford: Oxford University Press, 2004).

[45] Gonzalo Escribano and Javier García-Verdugo, 'Energy Security, Energy Corridors and the Geopolitical Context: A Conceptual Approach', in *Energy Security for the EU in the 21st Century: Markets, Geopolitics and Corridors*, ed. by José María Marín Quemada, Javier García-Verdugo, and Gonzalo Escribano (London; New York: Routledge, 2012), pp. 26–37 (p. 30).

[46] Interview with a senior official from the EC/ DG Energy, 03/05/2013, Brussels.

[47] Yergin, 'Energy Security and Markets', p. 52.

[48] It must be noted that, supply diversity as an element of energy security is not universally accepted across the energy spectrum, especially by the producer countries. The latter have been vocal about defining energy security in terms of security of supply and have called for more demand side guarantees for their energy sales. During the Group of Eight (G8) summit in St. Petersburg Russian president Vladimir Putin presented Russia's vision for global energy security. In doing so, he insisted on the necessity of *"providing demand guarantees for the producers, and sharing responsibilities and risks among energy suppliers, consumers, and transit states"*. Cited in Ariel Cohen, 'Russia: The Flawed Energy Superpower', in *Energy Security Challenges for the 21st*

Secondly, affordability is related to the price of a given fuel type. In order to be economically feasible, the utilised fuel must be purchased at reasonable and stable prices. However, the affordability of energy supply is not a straightforward notion, as it denotes different meanings for producer and consumer countries. If the former seek affordability as the *highest* possible price in energy sales, for the latter it is the *lowest* price for imported energy.[49] Such irreconcilable positions are further aggravated by the aspirations of the producers to increase their share in the consumer markets and ensure their dominance in price setting. In this regard, in order to reduce bias against either party, Escribano García-Verdugo suggests that, *"the requirement that prices be 'affordable' is assumed to mean that the price of energy should not be driven upward by market imperfections unrelated to the shifts in global or regional supply and demand".*[50] In other words, affordability of energy is not a benchmark of successful *energy politics*, but an outcome of energy supply under ***competitive*** market conditions, where price of the consumed energy is determined by the supply and demand balance and not by the political bargaining power among the involved parties. This by definition means that, the adequate level of energy supplies to the consumers (ampleness) is also determined by the market signals, as opposed to the central planning efforts of the public authorities.

The reliability of energy supply, finally, refers to the resilience of energy supplies to the arbitrary political disturbances, as energy imports from and through politically unreliable countries substantially increase the risks of energy supply to the consumers.[51] Here too, market-based energy provision is favoured by the EU not only for competitive price determination, but also for depoliticisation of energy supply - in other words, to ensure that supply of natural gas is not used as a political tool in international political interaction. This is especially an important issue in natural gas sector, for gas to the EU markets is hauled predominantly via pipelines. Pipeline transportation, on the other hand, entail *natural monopoly* - whoever controls the conduits can also exercise power over the access of other suppliers to the same networks for political, as well as economic considerations. In order to remove the conflict of interests among different actors in energy supply and transit, competitive and reliable energy supply necessitates the

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Century : A Reference Handbook, ed. by Gal Luft and Anne Korin (Santa Barbara, Calif.: Praeger Security International, 2009), pp. 91–108 (p. 93).

[49] Bassam Fattouh, 'How Secure Are Middle East Oil Supplies?', in *Energy And The Transformation Of International Relations: Toward A New Producer-Consumer Framework*, ed. by Andreas Wenger, Robert W Orttung, and Jeronim Perovic (Oxford: Oxford University Press, 2009), pp. 91–117 (p. 95).

[50] Escribano and García-Verdugo, 'Energy Security, Energy Corridors and the Geopolitical Context: A Conceptual Approach', p. 27.

[51] Escribano and García-Verdugo, 'Energy Security, Energy Corridors and the Geopolitical Context: A Conceptual Approach', p. 31.

establishment of the relevant regulatory institutions to serve as a framework within which free market(s) can operate,[52] which I will further analyse in Chapter III.

Hence, in the context of the establishment of the SGC the operational definition of the EU energy security can be summed up as: ***Energy security is the diversity of energy supplies under competitive market conditions, which ensures its affordability and reliability.*** This definition will serve as the basis of qualitative and quantitative assessment throughout this research and support the conceptual framework of this PhD. It is especially helpful for analysing the SGC in a two-dimensional framework, where the physical establishment of the corridor (hardware dimension) is to contribute to the diversity of supplies to the EU, while its Europeanisation (regulatory dimension) is (also) to bring about competitiveness of supply and transit via the SGC, while ensuring its affordability and reliability.

It is worth noting that, there is also a rational link between energy supply and the broader normative political engagement of the EU with foreign supplier and transit countries. This especially relates to those countries, which do not necessarily share the same normative governance values, such as democracy, rule of law and human rights, as the EU. The EU Commissioner for Energy and Climate Action Miguel Arias Cañete has recently noted, *"When it comes to energy, don't put your fate in the hand of autocratic regimes"*.[53] This, accordingly, requires foreign energy policies to be pursued in close synergy with broader common and foreign security agenda of the EU. Although this is an important issue that any research on energy security should be conscious about, I will not investigate energy security-normative governance nexus, largely due to space and time constraints. The next section will assess the regulatory dimension of the SGC in broad conceptual terms as discussed before.

4. External governance perspective and the SGC

The EU acquired its first direct Treaty competences in energy sector under the Article 194 of the TFEU (Article 176A - Lisbon Treaty) in the context of the establishment and functioning of the internal market, which include:

i. "ensuring the functioning of the energy market";

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[52] For a general analysis of the competition in natural gas markets, see e.g. Peter D. Cameron, *Competition in Energy Markets: Law and Regulation in the European Union* (Oxford: Oxford University Press, 2007).

[53] Miguel Arias Cañete, *Speech by EU Climate Action and Energy Commissioner Miguel Arias Cañete: 'Europe's Energy Security Challenges: La Unión Hace La Fuerza''* (Washington D.C./USA: Atlantic Council, 4 February 2015) <http://europa.eu/rapid/press-release_SPEECH-15-4086_en.htm> [accessed 21 June 2015].

ii. *"ensuring the security of energy supply in the Union; and"*

iii. *"promoting energy efficiency and energy saving and the development of new and renewable forms of energy; and"*

iv. *"promoting the interconnection of energy networks."*

However, the same article goes on to caution that, measures taken at the EU level "*shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply*".[54] This article leaves the EU in such a situation, where it can establish the rules for the organisation of the internal energy market(s), while competencies for determining domestic energy mix, quantities, (internal and external) sources and routes of energy supply lie exclusively within the remits of individual member states (and/or energy companies). To put it into perspective, the EU, under the current Treaties, cannot engage in common or individual gas purchasing on behalf of the member states or prevent them from buying gas from certain suppliers, force or stop member states from engaging with third-party actors on the determination of new energy supply routes, build necessary pipelines or address external challenges (e.g. transit risks) to its energy supply via traditional foreign policy instruments.

Such a discrepancy between the energy security goals of the EU and the relevant EU-level competences are further aggravated by the traditional collective action problems stemming from the "egoistic"/rational behaviour of the individual member states in cooperating with third countries. Member states way too often conduct external energy policies that are beneficial from the national interests point of view, but lead to the emergence of further energy security challenges for the EU as a whole. Hence, national level optimal decisions on (external) energy supply and route have a tendency to lead to sub-optimal outcomes at the system (EU) level.

In the past this was exemplified with Germany breaking ranks with other EU countries and supporting Russian Nord Stream pipeline. The latter linked Russian Federation directly with the German market while bypassing (and strategically undermining) Eastern EU member states; as Russia would no longer have to reckon with the latter and accommodate their concerns in order to reach out to German market, which constitutes Russia's biggest natural gas consumer.[55]

A similar discrepancy between the interests of the member states on the one hand and the

[54] 'Treaty of Lisbon: Amending the Treaty on European Union and the Treaty Establishing the European Community', Article 176A.

[55] See e.g. Jeffrey Mankoff, *Eurasian Energy Security* (New York: The Council on Foreign Relations (CFR), 2009).

EU (as a whole) on the other was also observed in relation to the SGC. While the EU had designated strategic importance to the SGC to bolster EU energy security[56], not all member states would benefit from it, hence, demonstrated lukewarm or even conflicting attitudes towards this corridor. Even the direct beneficiaries - South-East European countries, who had declared their support to the SGC right from the beginning, also signed up for the competing Russian South Stream pipeline project, which could have undermined the SGC should the EU level regulatory hurdles were surmounted. SGC offered an optimal choice for the EU as whole, while arguably SS offered benefits only to a number of individual member states.[57]

Similar collective action problems are also observed today, as Russian Gazprom, together with its German and Dutch partners venture to build Nord Stream 2 pipeline, calculated to completely zero Russia's dependence on Ukrainian (and Eastern EU) transit route. If reducing supply dependence on Russian gas is an ultimate strategic goal of the EU as a whole, then Germany's support to NS2, arguably, undermines this goal.[58]

Hence, the lack of external energy security competences of the EU limits the space for maneuver and the options available in the EU policy toolbox for dealing with external risks to its energy security. As the relevant competences are shared with the member states, the EU (at the supranational level) lacks the ability to act on external energy security issues in a similar fashion to *state* actors of international relations. In order words, the European Union lacks the *political attribute* in the matters of *external energy policy*.[59]

The lack of agency or actorness of the EU in a traditional foreign policy sense is, accordingly, reflected on the EU external energy policies, which considerably differ from the bilateral political approach of the member states. This, on the other hand, requires a new approach for a research design in order to analyse the policy actions taken aimed at addressing external challenges to energy supply via the SGC. *External governance*

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[56] 'President Barroso and Commissioner Piebalgs Welcome the Signature of the Nabucco Intergovernmental Agreement, Press Release, - IP/09/1114', *European Commisison*, 7 October 2009.

[57] For good discussions, see e.g. Pavel K. Baev and Indra Øverland, 'The South Stream versus Nabucco Pipeline Race: Geopolitical and Economic (ir)rationales and Political Stakes in Mega-Projects', *International Affairs*, 86.5 (2010), 1075–90; Caroline Dieckhoner, 'Simulating Security of Supply Effects of the Nabucco and South Stream Projects for the European Natural Gas Market', *The Energy Journal*, 33.3 (2012), 153–81; 'Signature of Nabucco Intergovernmental Agreement Marks New Era in EU Energy', *European Commission*, 2009 <http://ec.europa.eu/unitedkingdom/press/press_releases/2009/pr0985_en.htm> [accessed 27 June 2012].

[58] Barbara Lewis, 'Ten EU Nations Say Nord Stream Gas Extension Not in EU Interests', *Reuters*, 27 November 2015 <http://www.reuters.com/article/ukraine-crisis-nordstream-idUSL8N13L4MG20151127> [accessed 3 March 2016].

[59] Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', p. 49; Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 426; Lussac, 'Ensuring European Energy Security in Russian "Near Abroad": The Case of the South Caucasus'.

perspective presents a powerful tool to that end. Amounting to more than simple cooperation, external governance is understood here as the extension of the boundary of the EU's domestic institutions to cover its relations with third countries. Sandra Lavenex notes that, *"[i]n contrast to co-operation under an international agreement or convention, external governance takes place when parts of the acquis communautaire are extended to non-member states".*[60] Moreover, Lavenex and Schimmelfenning explain that the main characteristic of the external governance is the rejection of the *"projection of the unitary state actor model"* on the EU and concentration on the *"institutional processes of norm diffusion and policy transfer".*[61] Hence, *"[w]hereas a foreign policy perspective concentrates on countries or regions as units of analysis, the governance perspective takes systems of rules as its point of departure."*[62]

In the absence of the traditional foreign policy competences for dealing with the foreign actors and thereby containing the threats, EU external energy governance takes a different outlook to the resolution of the problem. Through the *politics of inclusion*[63] it rather aims to absorb the external disturbances in to the common regulatory framework, which previously has been successful in addressing similar challenges within the EU borders. Thereby, since the EU's domestic approach to ensuring energy security is based on a *regulated market model*, its external energy governance envisages the export of this model beyond its geographical borders.[64] Similarly, Lavenex argues that external governance fulfills "a dual purpose": *"It is not only motivated by benevolent civilian 'milieu goals', but is also driven by strategic 'possession goals' […]. External governance combines a foreign policy strategy geared at stabilisation and integration with the attempt to bind third countries to the pursuit of internal policy goals and thereby benefit from the latter's political and material problem-solving resources."*[65]

In the context of the SGC, external governance perspective allows to analyse the (resolution of) external transit and supply risks through the export and application of the

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[60] Sandra Lavenex, 'EU External Governance in "Wider Europe"', *Journal of European Public Policy*, 11.4 (2004), 680–700 (p. 683); In energy-specific context, see, e.g. Konoplyanik, 'A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)', p. 263.

[61] Sandra Lavenex and Frank Schimmelfennig, 'EU Rules Beyond EU Borders: Theorizing External Governance in European Politics', *Journal of European Public Policy*, 16.6 (2009), 791–812 (pp. 792–794).

[62] Lavenex and Schimmelfennig, 'EU Rules Beyond EU Borders: Theorizing External Governance in European Politics', p. 795; see also, *Governing Europe's Neighbourhood: Partners or Periphery?*, ed. by Katja Weber, Michael E. Smith, and Michael J. Baun (Manchester ; New York: Manchester University Press, 2007).

[63] Smith, 'The European Union and a Changing Europe: Establishing the Boundaries of Order', p. 23.

[64] For a similar argumentation, see e.g. Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', p. 49; Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 427.

[65] Lavenex, 'EU External Governance in "Wider Europe"', p. 694.

EU's relevant domestic norms and practices to the countries along this alternative energy corridor. However, the nature of EU rule export policy is different in intensity in relation to different countries along the SGC (Turkey, Georgia and Azerbaijan), which necessitates the analysis of the, so-called, ***modes*** of rule expansion of the EU.

To start with, Turkey, the territory of which constitutes the longest segment of the SGC, is a candidate country for EU membership. As such, Turkey is by default required to transpose the whole body of the EU law into the domestic legislation before it can be let it. Thus, in the context of the application of the EU rules along the SGC, the nature of the relations between Turkey and the EU is hierarchical.[66] With Azerbaijan and Georgia, however, it is less so.

In general, since the latest enlargement in 2004 and 2007, the EU's external borders have changed considerably and the Union has come to neighbour with regions and countries, which previously were considered as distant regions. Consequently, the EU has introduced a new institutionalised mechanism - European Neighbourhood Policy (ENP) - in its relationships with the neighbours.[67] Since inception in 2004, the ENP has promoted different initiative to construct the Union's relations with the neighbour in a dense manner, virtually in every sector, but under the membership line. In 2008 Poland and Sweden introduced the Eastern dimension to the ENP, called Eastern Partnership (EaP), which encompasses neighbours to the East of the EU, namely, Armenia, Azerbaijan, Belarus, Georgia, Ukraine and Moldova. In general terms, the goal of the EaP is *"to create the conditions to* ***accelerate political association and deepen economic integration*** *between the EU and the Eastern European partner countries"*,[68] which also includes comprehensive partnership in the field of *energy security*.

In this regard, with Azerbaijan and Georgia, the EU's relations are constructed *under the membership line* as far as the rule expansion is concerned. That is to say, neither Georgia, nor Azerbaijan has been granted a candidate status and the latter has not even expressed its desire to apply for EU membership in the foreseeable future. Therefore, the nature of relations between Georgia and Azerbaijan on the one hand and the EU on the other is less asymmetrical than the latter and Turkey.[69] In this regard, what we see here is two tier

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[66] See e.g. *The Europeanization of Central and Eastern Europe*, Cornell Studies in Political Economy (Ithaca, NY: Cornell University Press, 2005).

[67] The European Neighbourhood includes Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, the Republic of Moldova, Morocco, the Occupied Palestinian Territories, Syria, Tunisia and Ukraine.

[68] 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13' (European Commission, High Representative of the EU for FASP, 2012), p. 3 (emphasis original).

[69] See e.g. Kataryna Wolczuk, 'Perceptions Of, and Attitudes Towards, the Eastern Partnership amongst the Partner Countries' Political Elites', *Eastern Partnership Review*, 2011; Kataryna Wolczuk, 'Convergence Without

power relationships between the EU and the main actors of the SCG. Thus, any analysis of the export of EU's energy *acquis* must take into account different modes of relationships between the EU and the SGC countries.

In conceptualising the differences in intensity of external governance during the enlargement process and the current neighbourhood policy, Schimmelfenning, Lavenex, Lehmkuhl and Wichmann identify three modes of rule expansion towards the partner countries: hierarchy, network and markets modes.[70]

Hierarchy mode - envisages power asymmetries between the "rule exporter" and the "rule importer", the EU and the candidate countries and requires the existence of exact rules, procedures, monitoring and sanctioning mechanisms *"for the effective exercise of conditionality as a mode of top-down policy transfer on the basis of external incentives"*.[71] In a nutshell, *hierarchy mode* of external governance envisages the export of the EU rules and policies on to the candidate countries, acceptance of which will be rewarded with full membership in the Union. In terms of mechanism of rule expansion, it entails vertical, *top-down* (leverage) wholesale export of the EU rules and requires harmonisation of the candidate countries' rules and institutions with that of the EU and in principle, is considered to undermine the autonomy of the candidates over their legislation. Thus, hierarchy mode of external governance targets the entire polity (rather than individual sectors) and has been the primary mode of rule expansion during the EU enlargement.[72] It is currently aimed at candidate countries, including Turkey.

Network mode - in formal terms entails symmetric power relations between the EU and third countries, where the latter retains its autonomy. In this mode, although the EU *acquis* and policies dominate the agenda partner countries are expected to *"agree with the selection of topics of co-operation and can bring in their own priorities"*.[73] In other words, rule selection (legalisation) is carried out based on *joint ownership* principle. Nevertheless, as I will demonstrate through primary policy investigations, there is little difference

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Finalité: EU Strategy Towards Post-Soviet States in the Wider Black Sea Region', in *The Black Sea Region and EU Policy: The Challenge of Divergent Agendas*, ed. by Carol Weaver and Karen Henderson, 2010, pp. 45–48 (pp. 45–48); Nicu Popescu, Andrew Wilson and European Council on Foreign Relations, *The Limits of Enlargement-Lite: European and Russian Power in the Troubled Neighbourhood* (London: European Council of Foreign Relations, 2009).

[70] Lavenex and Schimmelfennig, 'EU Rules Beyond EU Borders: Theorizing External Governance in European Politics'; Sandra Lavenex, Dirk Lehmkuhl and Nicole Wichmann, 'Modes of External Governance: A Cross-National and Cross-Sectoral Comparison', *Journal of European Public Policy*, 16.6 (2009), 813–33.

[71] Lavenex and Schimmelfennig, 'EU Rules Beyond EU Borders: Theorizing External Governance in European Politics', p. 797.

[72] For a comprehensive overview of different mechanisms of rule expansion, see e.g. Sandra Lavenex and Frank Schimmelfennig, 'EU Democracy Promotion in the Neighbourhood: From Leverage to Governance?', *Democratization*, 18.4 (2011), 885–909.

[73] Lavenex, Lehmkuhl and Wichmann, 'Modes of External Governance: A Cross-National and Cross-Sectoral Comparison', p. 816.

between the *network* and *hierarchy* modes of external EU governance, as far as the selection of rules (to be exported) is concerned. Additionally, unlike the hierarchy mode institutional organisation of the relationships (institutionalisation) can be both centralised and decentralised and ties can be formal and informal. Therefore, main rule expansion mechanism tends to be more horizontal and sectoral, where the EU is trying to insert its norms into the sectoral administrative governance (*governance* and *linkage* mechanism),[74] rather than the entire polity.[75] Finally, the monitoring of the policy and rule implementation is political compared to judicial monitoring of hierarchy mode.[76] I will further analyse the rule selection, institutional organisation and monitoring aspects of the EaP in the context of the SGC in Chapter III.

Market mode - envisages more of a coordination of relations between the parties on *ad hoc* basis, without *"overarching legal commitment to co-operation, and approximation to the acquis is not the point of reference"*.[77] As such, market mode of external governance is less relevant for the EU's relations with the SGC countries, where both sides have, in principle, agreed to building deep and comprehensive institutionalised partnership on a permanent basis. Therefore, in this PhD I will concentrate on *hierarchy* and *network* modes of external energy governance of the EU towards Turkey, Georgia and Azerbaijan, respectively.

To sum up, since the regulatory dimension of the EU's SGC strategy envisages the liberalisation and depoliticisation of this alternative energy corridor, conceptually, this policy is underpinned the EU external energy governance, which aims at the (external) Europeanisation of the SGC. In relation to Turkey, the EU external energy governance envisages the export of the EU rules in hierarchical manner, for Turkey is an EU candidate country. In relation to Georgia and Azerbaijan, however, EU external energy governance is

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[74] In conceptualising the EU's democracy promotion in its neighbourhood Lavenex and Schimmelfenning identify three models of mechanisms of change in the third countries: *leverage* (top-down conditionality), *linkage* (bottom-up socialisation) and *governance* models (horizontal partnership). In this regard, while the first model envisages intergovernmental conditionality placed upon the third countries, the linkage model targets civil society and attempts to enable and empower *"societal, non-governmental actors to work for the democratisation of their home country from below"*. Lavenex and Schimmelfennig, 'EU Democracy Promotion in the Neighbourhood: From Leverage to Governance?', pp. 890–891.

In contrast, being less top-down than leverage and less bottom up than linkage, governance approach *"operates at the level of democratic principles embedded in the governance of individual policy fields and unfolds through the deepening of trans-governmental, horizontal ties between the EU and third countries' public administrations"*. Lavenex and Schimmelfennig, 'EU Democracy Promotion in the Neighbourhood: From Leverage to Governance?', p. 887.

[75] Lavenex and Schimmelfennig, 'EU Democracy Promotion in the Neighbourhood: From Leverage to Governance?' However, as I will illustrate in detail in the empirical chapters of this PhD that, as far as the energy sector is concerned, the EaP is little different from the accession process in terms of the density of the rules the EU is trying to export without membership prospects.

[76] Lavenex, Lehmkuhl and Wichmann, 'Modes of External Governance: A Cross-National and Cross-Sectoral Comparison', p. 816.

[77] Lavenex, Lehmkuhl and Wichmann, 'Modes of External Governance: A Cross-National and Cross-Sectoral Comparison', p. 815.

based on network mode, for the countries at the receiving end have to agree to the selection of rules and can bring their own priorities to the table. In accounting to these issues, this thesis draws a great deal from the Europeanisation literature in order to investigate the EU policies pursued under the regulatory dimension of the SGC and the factors conditioning their success or failure.

It is important to note that, (external) Europeanisation is a broad concept and refers to *"the influence of EU policies and values on the 'rest of the world', i.e. non-member states"*.[78] Such a broad conception of the term encompasses external material and ideational influence of the formal EU policies and legislation (*acquis*), as well as the EU (European) identity and discourse on the political, economic and cultural outcomes in third countries. Admittedly, the level of material and ideational influence in external Europeanisation varies depending on the target spheres/sectors in question. The extent to which political, economic and social outcomes in third countries are influenced by the change of ideas preceding the policy choices (as a consequence of *Europeanisation*) is, arguably, dependent *inter alia* on the formality and determinacy of the rules that bring about the outcomes in question. Existing EU policies underpinned by dense and determinate formal rules are more likely to lead to external Europeanisation in material terms. While less dense and less determinate EU policies and norms are likely to have a more ideational and discursive influence on the behaviour of the third countries.[79] For example, external Europeanisation in the sphere of democratic governance entails both material and ideational changes in the target countries, as democracy requires the existence of certain formal/material institutions in the polity, but cannot be reduced to a single formal model of governance. It needs to be complemented with *ideational* transformations in third countries with regard to the *legitimate way(s) of state governance*, the *identity of the governors* and/or *the electorate* and in general, the process of socialisation through which EU (and international) norms are internalised into domestic practices in the target countries.[80] However, the scope for *ideational* transformations is non-existent or insignificant, if the Europeanisation aims to install a ready-made formal model of, for example, *third-party access* regime to transmission pipelines in third countries. Whether

[78] Heritier, 'Europeanization Research East and West: A Comparative Assessment', p. 200.

[79] However, these two types of external influences should not necessarily be mutually exclusive. The differentiation is made here only to point out to the dominant influence of the formal and dense EU *acquis* on the material outcomes in third countries.

[80] See e.g. *The Persistent Power of Human Rights: From Commitment to Compliance*, ed. by Thomas Risse-Kappen, Stephen C. Ropp, and Kathryn Sikkink (Cambridge: Cambridge University Press, 2013); Thomas Risse, *A Community of Europeans?: Transnational Identities and Public Spheres* (Ithaca [N.Y.]: Cornell University Press, 2010); Ian Manners, 'Normative Power Europe: A Contradiction in Terms?', *JCMS: Journal of Common Market Studies*, 40.2 (2002), 235–58; Maria Green Cowles, James A. Caporaso and Thomas Risse-Kappen, *Transforming Europe: Europeanization and Domestic Change* (Cornell University Press, 2001); Richard Youngs, 'European Union Democracy Promotion Policies: Ten Years On', *European Foreign Affairs Review*, 6.3 (2001), 355–73.

the target countries consider the EU model *legitimate* or not, is irrelevant and it does not require the change of *identity* or *thinking* in order to implement it properly. The EU rules in this sphere are very *dense* and *determinate* and do not necessarily dependent on the process of socialisation in order to ensure their *correct* implementation, which avails itself to empirical observation (although, admittedly, not always quantifiable).

Hence, since this PhD focuses only on the influence of the EU natural gas rules, which are dense and determinate, on the relevant third country policies, the notion of *Europeanisation* I am interested in is also limited to its formal and material outcomes. Consequently, for the purpose of this PhD, the "Europeanisation of the SGC" refers only to the influence of the determinate EU *acquis* and policies on *the natural gas sectors* in the target countries, namely, Turkey, Georgia and Azerbaijan (and not the entire policy or society).

The next section of this chapter provides the review of academic literature on the SGC, while the subsequent section defines the theoretical terrain of this thesis.

5. Literature Review on Southern Gas Corridor

The contemporary literature on energy security is probably one of the fastest expanding strands of academic research on security issues and has traditionally been studied within the subject field *Security Studies* - a sub-field of International Relations. However, in the last couple of decades, energy as a subject matter has transcended the boundaries of Security Studies/International Relations and become an important topic for academic research in *Economics* and *Legal Studies*.

The diversity of approach to academic research on *energy security* is driven not only by the relevant academic background of individual scholars, e.g. politics, economics, law and sociology. It is also influenced by the very definition of energy security by individual countries or group of countries and the fuel type that they relate their energy security with. Daniel Yergin, one of the first scholars to re-generate academic interest to energy security, argued that for the United States, energy independence and the desire to decrease its oil import dependence is of foremost concern. For other consuming *leviathans*, especially for China and India, energy security is linked to their economic growth and ensuring that the lack of (all) energy supplies does not stymie thereof.[81] According to Daniel Yergin, *"for Russia, the aim is to reassert state control over "strategic resources" and gain primacy over the main pipelines and market channels through which it*

[81] Yergin, 'What Does "Energy Security" Really Mean?'

ships its hydrocarbons to international markets."[82] Even when the priorities within the widespread definition of energy security ("*the provision of affordable, reliable, diverse and ample supplies of*" energy resources and the existence of adequate infrastructure)[83] are concerned, the national differences are quite stark. For example, while the US and China puts the emphasis on the reliability of supplies,[84] the European Union places the priorities on the *security of supply* and *competitiveness* (and *sustainability)* of energy supply,[85] while policy debates centre around the ways of managing the dependence on imported natural gas.[86]

In general, literature on the SGC in the context of the EU natural gas security can be separated into two distinct but interrelated themes/storylines:

1) Energy geopolitics and 'regions and empires',

2) Energy interdependence and 'markets and institutions'.[87]

The following sections review these storylines in relation to the SGC and locate this research in the broader academic literature.

5.1. SGC in the 'regions and empires' debate

Scholars in this group take a geopolitical approach to external energy supply and argue that energy strategies of the supplier countries are tainted with their national interests in a *Hobbesian* sense. Therefore, external energy supply has a structural quality to advance the foreign policy agenda (both geopolitical and geo-economical) of the supplier countries. Markets alone cannot eliminate these risks, thus supply of energy must be treated as a matter of national security.[88]

From the perspective of the EU natural gas security, the main emphasis is placed on the traditional security implications of the EU's over-dependence on Russian natural gas supplies, as well as increasing international competition over the scarce energy resources. More specifically, Zeyno Baran argues that, *"Russian power and influence is no longer*

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[82] Daniel Yergin, 'Ensuring Energy Security', *Foreign Affairs*, 85.2 (2006), 69–82 (p. 71).

[83] Kalichi and Goldwyn, 'Introduction: The Need to Integrate Energy and Foreign Policy', p. 9 (emphasis added).

[84] Brenda Shaffer, *Energy Politics* (Philadelphia: University of Pennsylvania Press, 2009), p. 93.

[85] *Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy, COM (2006) 105*.

[86] Yergin, 'Ensuring Energy Security', p. 71.

[87] For comprehensive discussions on these storylines, see e.g. *Study on Energy Supply Security and Geopolitics* (The Hague, the Netherlands: Clingendael International Energy Programme (CIEP), Institute for International Relations 'Clingendael', 2004); Richard Youngs, *Energy Security: Europe's New Foreign Policy Challenge* (London: Routledge, 2011); Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?'

[88] Yergin, 'Ensuring Energy Security'.

measured in ballistic missile accuracy or bomber production but in miles of pipeline constructed and barrels of oil per day exported, and for Europe, this energy invasion has already begun".[89] Similarly, Ariel Cohen indicates that Russia, *"has demonstrated its readiness to use hydrocarbon muscle and newfound wealth as a political tool in its relations with neighbouring states"*.[90] Furthermore, Robert Larsson argues that Russian energy strategy is based on imposing asymmetric dependence on the EU, while ensuring its independence in foreign policy choices.[91]

Extant literature on the SGC has largely grown from the discussions in this group of research and has rather been presented as a foreign policy action of the EU in order to counter-balance its dependence on Russia. In line with the conventional geopolitical approach, it is argued that EU's political support to directly connecting the Caspian Basin and the Middle Eastern energy reserves to the EU markets via new energy infrastructure bypassing Russia will reduce the Union's dependence and geopolitical vulnerability vis-à-vis the latter. Mert Bilgin introduces the concept of "*western energy corridor through Turkey (WECT)"* (a euphemism for SGC) and argues that, inner-Caspian states - Azerbaijan, Kazakhstan and Turkmenistan together present a potent alternative energy source to counter-balance the EU's current dependence on Russia.[92] What is more, similar to Baran,[93] he posits that directly linking this region with the EU will also expand secure zone in the

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[89] Zeyno Baran, 'EU Energy Security: Time to End Russian Leverage', *The Washington Quarterly*, 30.4 (2007), 131–44 (p. 131).

[90] Cohen, 'Russia: The Flawed Energy Superpower', p. 92.

[91] Robert L. Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier* (Stockholm: FOI: Swedish Defence Research Agency, 2006), p. 4; see also, Harley Balzer, 'The Putin Thesis and Russian Energy Policy', *Post-Soviet Affairs*, 21.3 (2005), 210–25; Andrew Monaghan, *Russian Oil and EU Energy Security* (Defence Academy of the United Kingdom: Conflict Studies Research Centre, 2005); Per Högselius, *Red Gas: Russia and the Origins of European Energy Dependence* (New York, NY: Palgrave Macmillan, 2012).

[92] Mert Bilgin, 'New Prospects in the Political Economy of Inner-Caspian Hydrocarbons and Western Energy Corridor Through Turkey', *Energy Policy*, 35.12 (2007), 6383–94; Bilgin, 'Geopolitics of European Natural Gas Demand: Supplies from Russia, Caspian and the Middle East'; see also, Erkan Erdogdu, 'Bypassing Russia: Nabucco Project and Its Implications for the European Gas Security', *Renewable and Sustainable Energy Reviews*, 14.9 (2010), 2936–45; *Europe's Energy Security: Gazprom's Dominance and Caspian Supply Alternatives*, ed. by Svante E Cornell and Niklas Nilsson (Washington, D.C.: The Central Asia-Caucasus Institute, The Silk Road Studies Program, 2008); Karbuz, 'Review of the EU Strategy on Energy towards the Black and Caspian Sea Basins'; Dieckhoner, 'Simulating Security of Supply Effects of the Nabucco and South Stream Projects for the European Natural Gas Market'; Uwe Remme, Markus Blesl and Ulrich Fahl, 'Future European Gas Supply in the Resource Triangle of the Former Soviet Union, the Middle East and Northern Africa', *Energy Policy*, 36.5 (2008), 1622–41 (p. 1637); Dimitrios Mavrakis, Fotios Thomaidis and Ioannis Ntroukas, 'An Assessment of the Natural Gas Supply Potential of the South Energy Corridor from the Caspian Region to the EU', *Energy Policy*, 34.13 (2006), 1671–80.

[93] Baran, 'EU Energy Security: Time to End Russian Leverage'; Zeyno Baran, 'Developing a Cohesive EU Approach to Energy Security', in *Europe's Energy Security: Gazprom's Dominance and Caspian Supply Alternatives*, ed. by Svante E Cornell and Niklas Nilsson (Washington, D.C.: The Central Asia-Caucasus Institute, The Silk Road Studies Program, 2008), pp. 155–66; see also, Erdogdu, 'Bypassing Russia: Nabucco Project and Its Implications for the European Gas Security'.

EU neighbourhood and contribute to the independence of the regional states from Russian influence.[94]

Shaffer takes this debate further in the geopolitical scale and argues that, international focus on the Caspian Basin largely stems from the region's geopolitical significance as a strategic junction between Europe and Asia. Therefore, the control over the *"energy export projects [from the region] provides significant influence over the security and political outcomes and policies of the Caspian states";* thus, the battle over the regional export routes is *"more about determining the geo-strategic orientation of the region than control of the Caspian states' modest volumes of oil and gas"*.[95] Shaffer concludes that, the August 2008 war between Russia-Georgia, which was the result of Russia's aggressive reaction against Western meddling in its *near abroad*, served as a "major watershed" in the regional energy race, potentially rendering the Caspian Basin "as highly risky" for commercial investments.[96]

Additionally, against the backdrop of skyrocketing economic development in East, South and South-East Asian countries, experts also raise concerns about the increased competition among the major "empires" over the scarce energy sources and question the availability of energy resources in need.[97] Others warn against the volatile security environment along the expected transit corridor that will bring new gas supplies from the Caspian Basin. Crandall argues that increased terrorism in Turkey is of huge concern in this regard. Although the pipelines traversing Turkish territory are buried, the pumping stations remain above the surface, which represents an easy target for PKK Kurdish terrorists who aspire to destabilise the region and achieve secession from Turkey. Additionally, there is less than 30 km between the South Caucasus Pipeline (a Caucasian part of the SGC) and the Nagorno Karabakh (NK) conflict, which destabilises the region as a result of Armenian occupation of Azerbaijani territories. Crandall warns that, *"if war resumes, shipments are likely to be interrupted, as Armenia will seek to deny its enemy a*

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[94] Bilgin, 'Geopolitics of European Natural Gas Demand: Supplies from Russia, Caspian and the Middle East'; Ariel Cohen, 'Energy Security in the Caspian Basin', in *Energy Security Challenges for the 21st Century: A Reference Handbook*, ed. by Gal Luft and Anne Korin (Santa Barbara: Praeger Security International, 2009), pp. 109–27.

[95] Brenda Shaffer, 'Caspian Energy Phase II: Beyond 2005', *Energy Policy*, 38.11 (2010), 7209–15 (p. 7210).

[96] Shaffer, 'Caspian Energy Phase II: Beyond 2005', p. 7213.

[97] Kalichi and Goldwyn, 'Introduction: The Need to Integrate Energy and Foreign Policy'; Gawdat Bahgat, 'Europe's Energy Security: Challenges and Opportunities', *International Affairs*, 82.5 (2006), 961–75; Mikkal Herberg, 'Fuelling the Dragon: China's Energy Prospects and International Implications', in *Energy And The Transformation Of International Relations: Toward A New Producer-Consumer Framework*, ed. by Andreas Wenger, Robert W Orttung, and Jeronim Perovic (Oxford: Oxford University Press, 2009), pp. 269–97; Shaffer, *Energy Politics*, p. 46.

source of funds. These are wild cards, but cannot be ruled out".[98] Supported by these factors, Crandall argues that from the security point of view, Southern Gas Corridor is not suitable for safe transportation, ultimately diminishing Caspian (and Middle Eastern) energy source's importance.

In sum, the EU's increased political engagement with the Caspian Basin and the Middle East via the SGC is construed as a geopolitical storyline in the Union's external energy security strategy. However, literature in this group largely ignores the lack of state attributes and capabilities; in short, lack of *actorness* of the EU in a conventional foreign policy sense. As I indicated at the beginning of this chapter, in view of this lack of classical foreign (energy) policy capabilities, the EU's external energy policy actions are rather based on the engagement with third countries through the extension of domestic norms and practices. Literature in this group, however, does not engage role of the EU rules in the establishment and future operation of the SGC, which is at the centre of analytical attention of the current thesis.

5.2. SGC in the 'markets and institutions' debate

In the second group, academic research has taken an *interdependence* approach to energy security and draws attention to the role of the increasingly globalised energy markets in reducing political tensions stemming from access to energy supply. Underpinned mainly by the liberal paradigm, proponents of this approach argue against ascribing a geopolitical role to energy supply and posit that globalisation has increased the *interdependence* between the energy producers and consumers. Therefore, energy security of the producers cannot remain unscathed by the challenges to the energy security of the consumers and vice-versa.

In this regard, Jeronim Perovic points out to the fact that the majority of Russian natural gas exports are destined for the European markets due to the fixed nature of gas transportation infrastructure and therefore, is inflexible. For this reason, Russia's high revenues from energy exports make it dependent on European energy demand, which consequently renders the possibility of "energy weapon" illogical illusion.[99] In a similar

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[98] Maureen S. Crandall, *Energy, Economics, and Politics in the Caspian Region: Dreams and Realities* (Praeger Publishers Inc, 2006), p. 68.

[99] Jeronim Perovic, 'Changing Markets, Politics, and Perceptions: Dealing with Energy (Inter-) Dependencies', in *Energy And The Transformation Of International Relations: Toward A New Producer-Consumer Framework*, ed. by Andreas Wenger, Robert W Orttung, and Jeronim Perovic (Oxford: Oxford University Press, 2009), pp. 26–59; Andreas Wenger, 'Toward A More Sustainable Global Energy System: Integrating Demand-Side and Supply-Side Policies', in *Energy And The Transformation Of International Relations: Toward A New Producer-Consumer Framework*, ed. by Andreas Wenger, Robert W Orttung, and Jeronim Perovic (Oxford: Oxford University Press, 2009), pp. 331–63; Fattouh, 'How Secure Are Middle East Oil Supplies?'

line, Paul Isbell argues that, *"[t]he highly interdependent nature of the world energy system goes a long way toward eliminating the real likelihood that premeditated supply cuts will be used to damage importing economies during peacetime. Commercial and state diplomacy can, and always have, taken care of the relevant residual risk".*[100] Furthermore, he argues that, *"[c]onsumers also need to be made aware of the real issues involved, within the context of emergency planning and demand management, as opposed to simply being led to believe there is a foreign demon on the horizon".*[101]

Pierre Noel takes this (normative) liberal argument a step further and argues that the concept of energy security is nothing but a "myth", as energy supply is and should be subject to free-market rules, while leaving political and hard power motivation aside. Thus, public intervention to energy supply vis-à-vis dependence on Russia is anything but counterproductive.[102]

In furthering this argument, other scholars argue that, in fact "energy weapon" is more exercised by consumers in the form of Western patronised sanctions in order to induce behavioural change in producing countries (Libya, Iraq and Iran are cases in point).[103] Thus, instead of alluding to the illusionary usage of "energy weapon" consumers should be more concerned about the underinvestment in upstream energy production and heavy domestic energy subsidisation due to domestic political reasons.[104]

In this regard, liberals indicate the rhetorical function of alleged "energy weapon", which feeds into the vicious cycle of "energy security dilemma" where all parties try to diversify away from each other because of the fear of being a subjects of energy weapon. As a consequence, it results in reduced confidence in the market and aggressive drive towards accessing scarce alternative sources. Therefore, liberals call to embrace interdependence, instead of independence and engage in constructive dialogue and furthering transparency in consumer and producer energy relations.[105] In this vein, John Gault suggests that, instead of alienating Russia, the EU has to push for more economic cooperation with Moscow, as it will lock up both European consumers and the Kremlin in mutual

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100 Isbell, 'Paul Isbell Revisits the Energy Security Debate', p. 3.

101 Isbell, 'Paul Isbell Revisits the Energy Security Debate', p. 4.

102 Pierre Noël, 'Challenging the Myths of Energy Security', *Financial Times*, 10 January 2008 <http://www.ft.com/intl/cms/s/0/40c2f8aa-bf93-11dc-8052-0000779fd2ac.html> [accessed 31 March 2012]; Pierre Noël, *Beyond Dependence: How to Deal with Russian Gas* (European Council on Foreign Relations, 2008).

103 Fattouh, 'How Secure Are Middle East Oil Supplies?', p. 96.

104 John Roberts, 'Energy Challenges for Europe', in *Energy And The Transformation Of International Relations: Toward A New Producer-Consumer Framework*, ed. by Andreas Wenger, Robert W Orttung, and Jeronim Perovic (Oxford: Oxford University Press, 2009), pp. 245–69 (p. 251).

105 Wenger, 'Toward A More Sustainable Global Energy System: Integrating Demand-Side and Supply-Side Policies'.

interdependence and eliminate any possibility of pre-mediated supply cut-offs. In this view, inviting Russian companies to invest in the EU will make them hostage to the host governments' policies and eliminate any residual risks.[106]

Finon and Locatelli, additionally, take a different and somewhat dialectical approach to the economic and political challenges stemming from the EU's dependence on Russia gas supplies. They recognise the increasingly *realist* mood that Russia has been engaging with its European partners and the deliberate, if only mistaken, *"politicisation of the gas issue by the [Vladimir] Putin government as a way of affirming Russia's ambitions to recover its international influence"*.[107] However, in doing so, the scholars argue that political risks stemming from the EU's dependence on Russia must not be extrapolated to Gazprom's business activities in Europe, which they argue is *"determined by market principles and the need of Russia for stable long-term contractual arrangements based on credible commitments"* and challenge the *"idea that Gazprom is not a reliable supplier".*[108] Thus, they differentiate energy dependence from energy security, considering the former a political issue, while the latter an economic matter. In doing so, Finon and Locatelli argue against the widespread notion that Gazprom acts in a monopolistic or oligopolistic manner when engaging with European gas consumers. They posit that, even if Gazprom did act in such a way, high market gas prices, resulting from such a market behaviour would *"attract projects from competitors outside the oligopoly of dominant producers, even if it owns the major resources around the regional market".*[109]

In this specific context, Finon also views the SGC as a geopolitical effort by the EU, despite its intrinsically limited hard powers in the strategic foreign (energy) security matters. In analysing the failure of the Nabucco pipeline, which initially was used synonymous to the SGC, the author argues that Russian Gazprom was more capable of galvanising energy, financial and political resources around the competing pipeline (South Stream) and pre-empt the target markets. Consequently, this made Nabucco (strategically) less competitive vis-à-vis the Russian project and lead to its demise.[110] He concludes that, there are too many "subjective premises" at the EU, *"which distort their perception of the reality concerning gas dependence risk. […] [and] there might be regrets that diversification of*

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[106] John Gault, 'European Security and Natural Gas Supplies', *Oxford Energy Forum*, 2007, 6–8.

[107] Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 441.

[108] Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 441.

[109] Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 432.

[110] Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project'.

sources do not occur when reaching new gas sources from Caspian and Middle East with the help of new corridors".[111]

In contrast to the current research, however, Finon strategically separates the EU's political support to the SGC, dubbed EU's "hard power" strategy from its "soft power" efforts. In his terms, if the former purports to provide the EU with tools of geopolitical power projection - building energy pipelines in order to reduce political dependence on Russia, the latter is busy with liberalising the rules governing energy trade towards the EU.[112]

Although Finon's analysis regarding the failure of the Nabucco pipeline is outstanding, his delineation of the hard and soft power elements within the SGC is less so. As it will be argued in this PhD, the policy of diversification and instilling EU rules along the energy corridor is not as separate as Finon portrays. This research will argue that, they are two different sides of the same coin (different *dimensions* of the same strategy), as rule extension is an integral part of the diversification strategy. It is aimed by the EU to be implemented through multilateral and bilateral rule extension instruments, but also to be embedded into the regulatory regimes governing individual projects along the SGC. As I will investigate in Chapter II, Nabucco pipeline incorporated the main principles of the EU's energy *acquis* - its "soft power", which would help the EU to source Caspian and Middle Eastern gas based on the EU preferences while eliminating transit risks along the route. Additionally, Finon equates the Nabucco pipeline to the Southern Gas Corridor. Although the former gave birth to the later, the later is broader in its scope than a single pipeline. The EU has set off its diversification strategy, not only by building (supporting) alternative supply/transit pipelines, but also promoting alternative corridor regulated by the EU rules, thus intrinsically interlinking the two elements - "hard and soft power" if to put it in Finon's terms.

In this context, a new but relatively small group of research endeavours have concentrated on conceptualising external Europeanisation, namely export of the EU *acquis* to third countries, as a bridge, which marries and overcomes the dilemma between neo-liberal markets and neo-realist geopolitics storylines in the EU's (external) energy policy.[113] In general, although some experts ascribe the EU external energy governance to the Union's

111 Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', p. 65.

112 Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project'; Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 427.

113 Escribano Francés, 'Market or Geopolitics? The Europeanization of EU's Energy Corridors'; see also, Youngs, *Energy Security: Europe's New Foreign Policy Challenge*; Lahn, Padgett and Lavenex, *External European Union Governance in Energy and the Environment*.

free-markets preferences in external relations,[114] not all scholars view it from markets perspective. Giselle Bosse argues that, EU's external energy strategy, which is assumed to be driven by the necessity to address energy security challenges, is not the result of hard "geopolitical facts" and is rather established in a discursive manner. She posits that, by securitising and dramatising energy supply challenges and its disadvantageous energy supply position, the EU attempts to influence policy developments in third countries by establishing a *neo-colonial* type of relationship.[115]

In contrast, Manoli describes the EU's rule export policy (in the context of ENP/EaP) as the EU's *civilian* power projection effort. However, according to her, these efforts are perceived by the regional hegemon (Russia) as a geopolitical power projection and by the receiving (EaP) countries as an instrument to counter it.[116]

With the notable few exceptions, which I review below, however, none of the above mentioned studies engage the first research question of this thesis: on the political and economic rationale of the EU external energy governance from the perspective of the SGC at the practical level. Especially lacking is the thorough analysis of the energy related rule expansion and enforcement mechanisms under the latest contractual commitments in relation to Azerbaijan and Georgia within the ENP/EaP framework. This is partly conditioned by the fact that, the latter policy instrument is considerably new in the EU's external governance repertoire and its contractual outcome materialised only in 2014. In short, existing literature does not provide detailed empirical analysis of how the EU energy (natural gas) *acquis* can potentially address transit risks along the SGC.

In this regard, Gareth Winrow presents valuable empirical research, where he ties Turkey's role in the establishment of the SGC to the country's EU accession negotiations. He articulates that, Turkey's tough stance in the SGC negotiations are directly linked to its need to ensure domestic energy security and use its energy transit position to leverage progress in the EU accession negotiations, especially vis-à-vis the opening of the blocked

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114 Brendan Devlin and Katrin Heer, 'The Southern Corridor – Strategic Aspects for the EU', in *Beyond Turkey: The EU's Energy Policy and the Southern Corridor*, ed. by Kristin Linke and Marcel Viëtor (Berlin: Friedrich-Ebert-Stiftung, 2010), pp. 5–10 (p. 6); see also, Prange-Gstöhl, 'Enlarging the EU's Internal Energy Market: Why Would Third Countries Accept EU Rule Export?'

115 Bosse, 'The EU's Geopolitical Vision of a European Energy Space: When "Gulliver" Meets "White Elephants" and Verdi's Babylonian King', p. 517; see also, Björn Hettne and Fredrik Söderbaum, 'Civilian Power or Soft Imperialism? EU as a Global Actor and the Role of Interregionalism', *European Foreign Affairs Review*, 10.4 (2005); Ondřej Horký-Hlucháň and Petr Kratochvíl, '"Nothing Is Imposed in This Policy!" The Construction and Constriction of the European Neighbourhood', *Alternatives: Global, Local, Political*, 2015; Elena Korosteleva, 'The Eastern Partnership Initiative: A New Opportunity for Neighbours?', *Journal of Communist Studies and Transition Politics*, 27.1 (2011), 1–21; Mary Farrell, 'A Triumph of Realism over Idealism? Cooperation Between the European Union and Africa', *Journal of European Integration*, 27.3 (2005), 263–83.

116 Panagiota Manoli, 'Political Economy Aspects of Deep and Comprehensive Free Trade Agreements', *Eastern Journal of European Studies*, 4.2 (2013), 51–73.

accession chapters.[117] Although the study is empirically extensive, it does not present an underlying theoretical framework that governs the logical actions taken by the relevant actors. Additionally, Winrow concentrates only on the Turkish section of the SGC and does not extend the analysis to the other parts of this alternative energy corridor.

Moreover, there is a deficiency of systematic academic research on the factors that condition the success and/or failure of the EU external energy governance in the context of the SGC, which is the main focal point of the second research question of this thesis. The notable exceptions are the research endeavours undertaken by Pardo Sierra and Lussac.

Pardo Sierra utilises *external governance* as a main conceptual framework to analyse EU's rules export policy vis-à-vis the Southern Gas Corridor (but excluding Turkey). In doing so, he identifies three *external* factors, namely, *lack of institutional policy coherence in the EU*, *regional geopolitics* and *domestic context linked to the regional-level dynamics*, as the main factors that lead to the failure of the EU's external energy governance vis-à-vis the extended Black Sea region (which also incorporates the Caspian Basin). In addition, Pardo Sierra argues if the SGC is to be a success story, it can only be possible due to the path-dependency process (stemming from regional producers' already existing energy supply links with the EU) and interdependence (stemming from dense economic relations) between the EU and the SGC countries.[118]

In a more recent work,[119] Pardo Sierra *largely* investigates the failure of Europeanisation of energy sectors in Georgia and Azerbaijan and ascribes it to the failure of the resonance of the *legitimacy* of the EU rules in the South Caucasus and the inability of the EU to engage in the region's hard security challenges.[120] However, in his own acknowledgement, Pardo Sierra does not analyse the implementation of the EU rules in the SGC countries *per se*. Furthermore, the analysis does not take account of the *domestic constraints* inhibiting the

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117 Winrow, 'Problems and Prospects for the Fourth Corridor: The Positions and Role of Turkey in Gas Transit to Europe'; Winrow, 'The Southern Gas Corridor and Turkey's Role as an Energy Transit State and Energy Hub'; Kardas, 'Turkish–Azerbaijani Energy Cooperation and Nabucco: Testing the Limits of the New Turkish Foreign Policy Rhetoric'.

118 Pardo Sierra, 'A Corridor through Thorns: EU Energy Security and the Southern Energy Corridor'; Pardo Sierra, 'No Man's Land? A Comparative Analysis of the EU and Russia's Influence in the Southern Caucasus'; for regional geopolitics as an inhibiting factor for external governance, see also, Antoaneta Dimitrova and Rilka Dragneva, 'Constraining External Governance: Interdependence with Russia and the CIS as Limits to the EU's Rule Transfer in the Ukraine', *Journal of European Public Policy*, 16.6 (2009), 853–72.

119 Pardo Sierra, 'No Man's Land? A Comparative Analysis of the EU and Russia's Influence in the Southern Caucasus'; Oscar Pardo Sierra, 'Life Is a Dream: EU Governance in the Southern Caucasus', *Dynamiques Internationales*, 2012.

120 It is also worth noting that, although Pardo Sierra also refers to domestic costs as one of the factors (although not the primary factor) in general terms, he does not provide any in depth systematic analysis thereof.

Europeanisation of the natural gas sectors of the SGC countries and its wide implications on future gas supplies via the SGC.[121]

Similarly, but not identically, Samuel Lussac argues that, the lack of strategic coherence among the views of the EU member states vis-à-vis the security of gas supplies from Russia was the main reason behind the EU's reluctance to get involved in the Caspian Basin pipeline politics. This has changed in the wake of the successive EU-Russia gas crises and lead to a more extensive EU involvement in the region through external energy governance.[122] Nevertheless, similar to Pardo Sierra, Lussac does not provide analysis of the *domestic factors*, which are assumed to affect the Europeanisation of the SGC.

Moreover, in analysing the adoption of the EU energy rules by third countries (with a reference to Georgia) with no EU membership prospects, Prange-Gstöhl presents *"demand side"* explanatory factors in the context of third-country membership in the Energy Community Treaty (EnCT). Prange-Gstöhl argues that, since the adoption of the EU energy *acquis* through EnCT is not linked to eventual EU membership conditionality, three major explanatory factors can potentially describe the willingness of third countries to adopt EU rules: 1) identification with Europe and willingness to demonstrate their capacity to one day become an EU member, 2) expectations to reduce their energy dependency on the regional hegemon, i.e. Russia, 3) economic gain, as common rules can potentially increase their economic exchange with the European Union, thus resulting in national development.[123]

However, among the non-EU SGC countries, only Georgia has applied for the EnCT membership with not much of a progress achieved in the accession process yet. Secondly, even in that case, the practical outcome of Georgia's voluntary EnCT membership will only duplicate the implications of the existing EU-Georgia AA/DCFTA, which is governed by '*conditionality*' on the part of the EU. Finally, Prange-Gstöhl does not evaluate the practical outcome of the adoption of the EU rules, thus, his broader conceptual position remains empirically invalidated.

In conclusion, there is abundance of academic literature on the SGC. However, systematic empirical research is lacking in relation to the attempted Europeanisation of the

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121 Pardo Sierra, 'A Corridor through Thorns: EU Energy Security and the Southern Energy Corridor'.

122 Lussac, 'Ensuring European Energy Security in Russian "Near Abroad": The Case of the South Caucasus'; for a more recent, but non-peer reviewed piece, see also, Edward Hunter Christie, Samuel Lussac and Kataryna Wolczuk, *The EU and Its Eastern Partners: Energy Needs and Future Prospects* (Brussels: Directorate-General For External Policies Of The Union, European Parliament, 2012); Lussac, *The State as a (Oil) Company? The Political Economy of Azerbaijan*.

123 Prange-Gstöhl, 'Enlarging the EU's Internal Energy Market: Why Would Third Countries Accept EU Rule Export?'

institutional governance of the SGC; in terms of its practical political and economic rationale, the role of domestic constraints in the target countries in affecting its success, as well as its overall implications on the EU's conception of energy security. This is the specific gap in the academic literature, which this PhD aims to address.

In the following section, I identify the theoretical framework, which underpins the analyses throughout the thesis.

6. Theoretical framework: Rational Choice Institutionalism and External Incentive Model

Defining the theoretical framework is important, as it determines the vantage point through which I analyse the logical basis of actions undertaken by different actors along the SGC.[124] In line with the "domestic analogy" thesis[125], this PhD investigates the aims and the consequences of the attempted Europeanisation of the (natural gas policies of the) SGC countries based on the hierarchical and network modes of the EU external governance. Accordingly, the research questions inquire both the rationale of the external deployment of the EU institutions (*acquis*) and the role of domestic constraints, which condition their adoption/rejection by the target countries. Hence, an appropriate theoretical framework must be able to engage these questions and provide methodological solution for investigations in the case studies.

In this regard, as I argue in this PhD, through the *politics of inclusion*[126], the EU external governance aims at absorbing external disturbances (energy security risks) in to the common regulatory framework and addresses them via "*internal*" regulation. This thesis ushers in a *rationalist* analytical framework, for *instrumental* logic is assumed to be the main driver of the EU external governance on this particular instance. Admittedly, rationalist assumptions usually suffer from a *post-hoc* theorisation of the interests of the actors under investigation.[127] To soften this theoretical fallacy, my methodological solution is to inductively investigate the goals of the EU vis-à-vis the SGC as declared by the formal EU policy instruments and the content of the relevant EU legislation to be exported as much as realistically possible. As I argue further down the line, given the EU policy goals

[124] Here, I am only interested in explanatory purchase of the theory, which is deployed to explain (rather than critique) energy security in the EU context.

[125] Frank Schimmelfennig, 'Europeanization Beyond Europe', *Living Reviews in European Governance*, 4.3 (2009), p. 10.

[126] Smith, 'The European Union and a Changing Europe: Establishing the Boundaries of Order', p. 23.

[127] See e.g. Mark Pollack, 'Rational Choice and EU Politics', in *Handbook of European Union Politics*, ed. by Knud Erik Jorgensen, Mark Pollack, and Ben J. Rosamond (London; Thousand Oaks, Calif: SAGE Publications Ltd, 2007), pp. 31–56 (p. 33).

are intrinsically instrumental (aimed at ensuring competitive gas supply and eliminating external transit risks) and since the content of the EU energy *acquis* is in nature *problem-solving*, then a *rationalist* approach becomes very appropriate for investigating the case studies in this PhD.

Furthermore, ascribing an independent role to *domestic costs* in the determination of policy outcomes in the target SGC countries is also an inherently rationalist exercise. *Domestic costs* signal to the *constraining* (as opposed to *constitutive*) role of the context surrounding the actors concerned. Hence, combined with the assumption that the actors are utility-maximisers, a *constraining* context forces them to behave rationally in opting for the most beneficial (or the least costly) policy options available.

Against this backdrop, *Rational Choice Institutionalism (RCI)* presents a valuable theoretical approach for engaging the (formal) *institutional* elements of the SGC strategy in a strategic context. However, as a *second order theory of the social*[128] RCI is generally concerned with ontological and epistemological questions related to the deployment of formal institutions under the logic of rational-choice. It is not specific to any particular study domain, including International Relations or EU Studies. Therefore, in the context of the *regulatory* dimension the SGC, RCI does not provide domain specific explanatory tools in order to account for the factors that facilitate and/or inhibit the success and/or failure of the EU's rule extension strategy.

Therefore, I use the *first order* adaption of RCI, *External Incentive Model (EIM)* as the domain specific theoretical tool of this PhD in order to account for the inter-relations between *the domestic adoption costs* (causes) and the *failure* of the Europeanisation of the SGC (effect). With this in mind, below, I first, introduce RCI as a broader theoretical theme of this PhD and analyse its main arguments in the context of the EU's external energy governance vis-à-vis the Southern Gas Corridor. Then, I go on to outline the explanatory arguments of the EIM in relation to the factors affecting rule adoption in the target countries.

6.1. Rational-Choice Institutionalism

Since the EU external energy governance envisions external policy action based on domestic rules, *New Institutionalism,* especially its *rational-choice* version presents a valuable analytical tool in order to account for the rationale behind the EU policy of

[128] For explanation of the second and first order theories, see e.g. Alexander Wendt, *Social Theory of International Politics*, Cambridge Studies in International Relations (Cambridge, UK; New York: Cambridge University Press, 1999).

Europeanisation towards the SGC, which I have dubbed *regulatory* dimension of this alternative energy corridor. In general terms, what are the main precepts of the RCI and how does it explain the external energy governance of the EU?

To start with, by taking the *logic of calculus*, RCI assumes that individuals always strive to maximise the achievement of their objectives; accordingly, act strategically.[129] That is to say, they canvass all possible options of action that can help them to attain their objectives and select those options that confer the maximum amount of benefits.[130] As such, RCI is a methodologically *individualist* theory; in other words, the basic units of analysis are the individuals themselves and it seeks to explain *"both individual and collective behaviour as the aggregation of individual choices"*.[131] In the case of the EU external governance, we are interested in the collective behaviour (external policy choices) of the EU (its Institutions and member states) as constrained by the existing EU *institutions*, namely, Treaties and relevant secondary legislation (below).

Secondly, the main focus of analysis in RCI is not the preferences of the basic units (individuals or their aggregations at the state, supra-state or non-state actor level), but the *institutions* themselves. Institutions are defined as the rules, norms and organisational structures, which "*are robust over time, and lend themselves to comparisons across settings, as structured. They persist in roughly the same form from year to year, and their similarities to and divergences from objects sharing their label in other places also persist*".[132]

Since the actors' behaviour is based on *strategic calculus, "this calculus will be deeply affected by the actor's expectations about how others are likely to behave as well".*[133] Institutions, in this regard, structure these interactions and strategic behaviour *"by affecting the range and sequence of alternatives on the choice-agenda or by providing information and enforcement [e.g. penalties for defection] mechanisms that reduce uncertainty about the corresponding behaviour of others"*.[134]

This is not to say that the preferences and interests of actors do not matter. It is rather to point out that, the preferences of actors are exogenous to institutional analysis,[135] while

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[129] Kenneth A. Shepsle, 'Rational Choice Institutionalism', in *The Oxford Handbook of Political Institutions*, ed. by R. A. W. Rhodes, Sarah A. Binder, and Bert A. Rockman, Oxford Handbooks of Political Science (Oxford ; New York: Oxford University Press, 2006), pp. 23–39 (p. 30); see also, Pollack, 'Rational Choice and EU Politics'.

[130] Peter A. Hall and Rosemary C. R. Taylor, 'Political Science and the Three New Institutionalisms', *Political Studies*, 44.5 (1996), 936–57 (p. 939); see also, Duncan Snidal, 'Rational Choice and International Relations', in *Handbook of International Relations*, ed. by Walter Carlnaes, Beth Simmons, and Thomas Risse (New York: SAGE Publications Ltd, 2002), pp. 73–94.

[131] Pollack, 'Rational Choice and EU Politics', p. 32.

[132] Shepsle, 'Rational Choice Institutionalism', p. 27.

[133] Hall and Taylor, 'Political Science and the Three New Institutionalisms', p. 945.

[134] Hall and Taylor, 'Political Science and the Three New Institutionalisms', p. 945.

[135] Hall and Taylor, 'Political Science and the Three New Institutionalisms', pp. 939, 951.

their behaviour and potential strategies are constrained and shaped by the institutions they are bound with. Therefore, analysing the institutions is vital for predicting the outcome of strategic interaction among different players.[136]

From the viewpoint of the SGC, RCI presents a strategic outlook of energy relations. This is rather because, the *regulatory* dimension of the SGC is underpinned by the *logic of calculus.* It is geared towards addressing the external energy supply risks from and/or through third countries by expanding the boundary of the EU institutions (relevant energy *acquis*) to absorb the SGC countries and hence, take advantage of their problem-solving properties.[137] Consequently, the deployment of the EU institutions externally (Europeanisation) will allow the Union to determine the parameters (rules) that condition (and constrain) the capacity of third countries to make energy related strategic decisions along the SGC and tailor them to the EU preferences.

In this regard, RCI presents a more flexible theoretical tool; it does not directly favour *free-market* or *geopolitics* approach in its conception of what constitutes a rational action. Rational action is considered as the deployment of institutions in order to reduce the risks stemming from the behaviour of others by narrowing down the strategic policy options available for them. In the SGC context, this logic entails strategic implications, for it is set to bind the strategic capacity of one group of actors with the preferences of another. However, in doing so it does not contradict with the liberal precepts, for the institutionalisation of external energy relations based on domestic norms also envisages the export of the EU's *free-markets*[138] model in energy supply/transit to other countries. Hence, by accounting for the role of the formal institutions in a strategic context, RCI engages with the first research question of this thesis in an explanatory manner.

However, it is also important to note that, RCI is not a theory of security, Europeanisation or even politics as such. It is rather a *"second-order"* social theory in A. Wendt's terms, concerned with epistemological and ontological questions, such as *"the nature of human agency and its relationship to social structures, the role of ideas and material forces in social*

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136 Here the *constraining* role of the institutions take place at two levels: a) external governance deploys EU domestic rules externally to constrain the behavior of external actors and b) the choice and the availability of external governance itself as a tool of external action is also shaped and constrained by the existing formal institutions, such as the EU Treaties and the division of relevant competences in energy between the member states and the EU institutions.

137 Lavenex, 'EU External Governance in "Wider Europe"', p. 694.

138 It is also important to clarify that, here the *"free-markets"* model does not necessarily denote *"neo-classical liberal"* market in which private actors operate free of governmental intervention. Quite the opposite, the EU's *"free market"* model is a heavily regulated space, within which certain segments (such as supply activities) encourage competitive/profit-seeking behaviour, while others (such as transmission services and access to it) are subject to public regulation.

life, the proper form of social explanations and so on".[139] In order to translate this broad umbrella theory into a domain-specific analytical tool in the SGC context, there is a need for a mid-range theory in order to account for the factors that affect the outcome of the Europeanisation of natural gas sectors of the countries along the Southern Gas Corridor.

In the Europeanisation literature several mid-range theories have been prominent in the past two decades in accounting for the Europeanisation of third countries, including, *External Incentive Model (EIM), Social Learning Model (SLM)* and *Lesson-Drawing Model (LDM)*.[140] In the first two models, the principal actor in inducing the adoption of rules is the EU, while the latter investigates the underlying rationale of rule adoption that is triggered by domestic incentives of the rule-receiving end.[141] Since the adoption of rules that I am concerned with here are incentivised and driven by the EU, the LDM is not relevant for this research. SLM, on the other hand, is based on the *Sociological Institutionalism (SI)/Constructivism* at the ontological level. As such, SI is underpinned by the *logic of appropriateness* and explains the choice of action by the actors' *"internalised identities, values and norms"*.[142] Correspondingly, in contrast with the instrumental rationality of the RCI (*logic of calculus*), SI and SLM take *"the legitimacy of rules and the appropriateness of behaviour"* as the main factors that mark the process of the transfer of rules and their adoption by the actors at the receiving end.[143]

In general, energy relations are intrinsically *rational* at the empirical level, for what is at stake here is the material gains/losses it entails. Energy is the bedrock of every economic, military and social activity and is intrinsically underpinned by the logic of efficiency and security. As such, it by definition involves and necessitates the analysis of costs & benefits and is less affected by the *ideational* factors and *scripts* of appropriate behaviour in doing so. For this reason, the *logic of appropriateness* of the SLM is less relevant to analyse the factors affecting the Europeanisation of the SGC.

EIM, on the other hand, draws on the RCI and accounts for the relations between the rule transfer and adoption based on the *logic of calculus.* As such, it explains the adoption

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[139] Wendt, *Social Theory of International Politics*, p. 4; Pollack, 'Rational Choice and EU Politics', p. 32.

[140] These three models are by far not the only models in the Europeanisation literature. For a fantastic literature review on this subject see e.g. Schimmelfennig, 'Europeanization Beyond Europe'.

[141] Frank Schimmelfennig and Ulrich Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', in *The Europeanization of Central and Eastern Europe*, ed. by Frank Schimmelfennig and Ulrich Sedelmeier, Cornell Studies in Political Economy (Ithaca, NY: Cornell University Press, 2005), pp. 1–28 (p. 8).

[142] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 9; for a meta-theoretical basis, see e.g. James G. March and Johan P. Olsen, *Rediscovering Institutions: The Organizational Basis of Politics* (The Free Press, 1989), pp. 160–162.

[143] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 9.

and/or rejection of EU rules by the costs-benefits calculations of the actors at the receiving end, which in our case are the candidate (Turkey) and partner (Georgia and Azerbaijan) countries. Since the explanatory argument of this thesis attempts to analyse the role of *domestic constrains* in affecting the rule adoption by the SGC countries, the EIM provides a more relevant mid-range theoretical tool based on *logic of calculus (logic of consequences)*. In this regard, although the EU policies aimed at the Europeanisation of the SGC countries also include actions that target the socialisation of the latter into the *legitimacy* and the *appropriateness* of the EU rules in line with SLM, I concentrate only on the EIM for explaining the rejection of the EU natural gas *acquis* by Turkey, Georgia and Azerbaijan due to time and space constraints.

As indicated in section 4 of the current chapter, the EU external governance envisages different modes and corresponding avenues of rule expansion vis-à-vis third countries. In view of this, the *rationalist (*and *ideational)* explanations of rule expansion/adoption entail different combinations of final rewards, actor interaction, rule selection, institutional organisation and the end results within the rule expansion process. At the risk of oversimplification **Table 1** attempts to summarise these into a single chart below.

Table 1: Modes of External Governance and explanatory Models of Europeanisation | Compiled by the author using information from the existing literature and new policy developments.

	Hierarchy Mode				
	Reward	Actor interaction	Rule selection *(Legalisation)*	Institutional org. *(Institutionalisation)*	Results of rule expansion
Logic of Consequence	Full EU membership	Vertical intergovernmental leverage – wholesale export of EU *acquis*	Hierarchically 'imposed' by the EU - *legally binding*	Accession process	Harmonisation of rules and institutions
Logic of appropriate-ness	Full EU membership	Top-down and/or bottom up socialisation and persuasion of the target governments or societal actors about the appropriateness of its rules		Accession process	Harmonisation of rules and institutions

	Network Mode				
	Reward	Actor interaction	Rule selection *(Legalisation)*	Institutional org. *(Institutionalisation)*	Results of rule expansion
Logic of Consequence	Functional membership – *participation in the EU's functional institutions*	Horizontal trans-governmental *'governance'* – sectoral rule/practice export	Bilaterally 'voluntarily' defined based on 'joint ownership' – *legally binding*	Association Councils and Committees/ Partnership & Cooperation Councils and Committees	Adoption of bilaterally defined parts of sectoral *acquis* (energy)
			Multilaterally 'hierarchically' defined – *legally binding*	Energy Community Treaty, Energy Charter Treaty	Full adoption of sectoral *acquis* (energy)
Logic of appropriate-ness	Functional membership – *participation in the EU's functional institutions*	Horizontal trans-governmental *'linkage'* – *socialisation* and sectoral practice sharing	Multilaterally defined – *advisory and consultative*	EaP energy/3rd platform, EURONEST energy committee	Structural approximation of domestic legislation with that of the EU *acquis*

That being said, it is also important to note that the analysis that I carry out in this PhD is essentially synchronic; taking a snapshot of the policy timeline and then looking into the *rationalist* explanations of the policy choices made by the actors involved. This is conditioned by the specific analytical focus of this particular research endeavour. Nonetheless, if the analyses were to be extended to include certain ontological discussions about the nature of the objects being analysed (e.g. the *"real"*ity of the external energy supply risks and/or the *perceptions* linked to the policy choices made to address them), then *constructivism* as an ontological approach could actually enrich the investigations. This would be especially relevant in explaining how the policy choices made by the relevant actors were/could have been affected by the ideas that they held about their context/environment. It is often the case that, changes in the policies are preceded by the changes in the perceptions/ideas informing the policy.[144] Therefore, different approaches to the analysis of *the social/political* can be combined at different levels of analyses - from empirical to metaphysical.

6.2. External Incentives Model (EIM)

EIM was one of the most prominent explanatory models that have been widely used to analyse rule adoption by the Central and East European Countries (CEECs) during the 2004-2007 enlargement rounds. According to this model, the adoption of EU rules is set as a condition, that the candidate countries must implement in order to receive rewards from the EU, which can be in the form of assistance (technical and financial) and institutional

[144] See e.g. Colin Hay and Ben Rosamond, 'Globalization, European Integration and the Discursive Construction of Economic Imperatives', *Journal of European Public Policy*, 9.2 (2002), 147–67.

ties (association, cooperation or full membership).[145] In this view, the main thesis of EIM suggests that, "*A government adopts the EU rules if the benefits of EU rewards exceed the domestic adoption costs.*"[146] In specific terms, EIM presumes four key explanatory factors, which determine the potential outcomes of rule adoption:

1. **Determinacy of conditions/rules** - It is expected that the more the rules, which are set as a condition for the ultimate reward, are determinate, the more likely they will be adopted by the target governments.
2. **Size and speed of reward** - It is assumed that, the EU rules are more likely to be adopted if the reward is big (e.g. membership vs. association) and the delivery of this reward is not too far in the future.
3. **Credibility of conditional threats and promises** - This assumes that rules are more likely to be adopted when the conditional threats and promises are big and vice-versa. In a nutshell, it suggests that, if the EU is not able to withhold the rewards with little or no cost to itself, or is more interested in rewarding the target government than punishing them, then its conditional external incentive will have little or no impact in bringing about change in the latter.
4. **The role of veto players and net adoption costs** - This assumes that EU rules are less likely to be adopted when the number of veto players (sub-state actors), which incur net adoption costs, e.g. opportunity costs, welfare and power losses, increase.

These individual explanatory factors provide a useful analytical tool for analysing the role of *domestic costs* in Turkey, Georgia and Azerbaijan in conditioning their willingness to adopt the EU rules in natural gas sector in a *cause and effect* manner. Analysis of these factors, consequently, will allow me to unearth different risks to competitive energy supply to the EU via the Southern Gas Corridor and the roles and preferences of variety of (both state and non-state) actors therein. These investigations necessitate the use of variety of research methods, which I present in the following section.

It is also important to note that, arguably, the authoritarian nature of the regimes in the case study countries might also have a role to play in their adoption/rejection of the EU rules. Considering that natural gas supply/transit has an inherently (geo)political utility to it, then it seems all the more reasonable to assume that wielding strong governmental control over the energy sector (e.g. by rejecting EU rules) is also aimed at ensuring

[145] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 10.
[146] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 12.

the longevity of the ruling regimes. This is rather because, the latter could serve as a leverage against the *normative* pressures stemming from the EU. Indeed, elite interests could well be presented as national interests in order to justify the policy choices made by the governments.

As such, it seems to be a very reasonable assumption as it (rightly) points to the instrumental use of energy supply/transit for the attainment of political objectives (i.e. regime survival) of the (group of) individuals. Nonetheless, from the viewpoint of deployment of rationalist analytical model, the analysis of this aspect of rule adoption/rejection by the target SGC countries creates substantial unsolicited problems. The problem arises when one ventures to uncouple the interests of the ruling elite from the *real* national interests of the state. The *real* national interests of the countries in questions are assumed to be subverted and are no longer considered to be those as declared through the formal avenues (e.g., legislation, official policy strategies, speeches, interviews, newspaper articles, etc.). They have to be disentangled from the "parasitic invasion" of the personal interests of the ruling elite through the *normative* judgement of the researcher. This would require a secondary research question on - *What **should have been** the domestic costs/benefits that would push the governments to adopt/reject the EU rules?* That, however, requires a *critique*, as opposed to (arguably) dispassionate and neutral *analysis* of the rule adoption and/or rejection process. Rationalist theoretical framework, in contrast, does not engage in the *critique* and is ill equipped to deal with a *normative* terrain in the analysis of the political.

That being said, however, it is not to argue that the role of the elite interests in the rejection of the EU rules is not compatible with a rationalist explanation. It is rather to point out that the rationalist explanatory model is not capable of disentangling the *elite interests* from the *real national interests* in methodological terms. Hence, under such a framework one could only suffice with referring to their potential negative impacts of the elite interests in the authoritarian political culture in the SGC countries on the rule adoption process. However, their delimitation from the "*real*" national interest will remain beyond the capacity of this research.

7. Research design and methodology

It goes without saying that methodology is one of the most important elements of any serious academic research endeavour and ultimately conditions the outcome of analysis throughout the research. As I presented at the beginning of this chapter, this thesis

presents a two-dimensional structure for analysis of the SGC in order to account for different cross-cutting elements, namely, hardware and regulatory elements of this alternative energy corridor.

Although each of these dimensions is part of the same strategy, objectives in each of them serve as an additional layer of safety for gas supply via the SGC. In this regard, the two-dimensional research framework is designed in order to (only) *analytically* separate the actions pursued by the EU in order to safeguard diverse and competitive gas supply via the SGC. Admittedly, the failure in one of these policy strands will ultimately affect the other, too. Nevertheless, the contribution of hardware and software elements of the establishment of the SGC to the EU energy security will be different, although complementary. Where the physical establishment of the corridor (hardware dimension) is to contribute to the diversity of supplies to the EU, while its Europeanisation (regulatory dimension) is also to bring about competitiveness of supply and transit via the SGC, while ensuring its affordability and reliability.

Indeed, the analysis of the physical establishment of the SGC is important for presenting the complete picture of the development of this alternative energy corridor. Nonetheless, it is the regulatory issues along the SGC that is at the heart of this thesis. In general, the *regulatory* dimension of the EU's Southern Gas Corridor strategy is concerned with the level of harmonisation of the regulatory regime along the SGC with that of the EU and thus, the potential of addressing non-market risks therein. This strand of analysis is concerned with the *qualitative* compatibility of the regulatory regimes of the SGC countries with the EU domestic gas market rules and the factors affecting them. Therefore, the analyses I will pursue in this dimension will be qualitative, too.

In general, the explanatory argument of this thesis is embedded into a descriptive comparative context. That is to say, the effects that I aim to explain, the failure or success of rule adoption in Turkey, Georgia and Azerbaijan are not pre-given and need to be revealed by the researcher before any causes bringing about these effects can be identified. To put it simply, I need to first comparatively describe whether EU's natural gas market rules have been adopted by the SGC countries or not, before investigating the underlying reasons thereof. Such a complex research design requires two tier methodological analysis on each of the countries, which are the subjects of the case study of this PhD, namely Turkey, Georgia and Azerbaijan.

I. In the first tier, the analysis focuses on whether or not the subject countries have adopted EU natural gas legislation. In order to achieve this goal, I use descriptive comparative analysis of the *institutional documents* as my main method of data collection

and analysis. Institutional document analysis, in this regard, is the most reliable source for data collection for descriptive comparative analysis, as they provide formal, credible and publicly available source of information. Nonetheless, given that the extent of EU legislation to be adopted by the target countries is overwhelming (even in a single policy sector like natural gas), any realistic descriptive comparative analysis can only afford to concentrate on a handful number of benchmarks/milestones. Selection of the relevant benchmarks, on the other hand, will require deep review of the secondary literature, as well as the official EU materials. This is especially vital for the success of the research, as these benchmarks will carry out strategic objectives for the EU external natural gas supply, as I will indicate in Chapter III.[147]

Furthermore, descriptive comparison raises another set of issues as regards the objects of description. The problem here is associated with the fact that adoption of certain normative acts (EU rules) domestically does not necessarily denote their implementation in practice, which has been dubbed *"Potemkin harmonisation"* in the Europeanisation literature.[148] In order to avoid this problem, I screen both the relevant legislative acts on both sides, as well as refer to the latest practical developments affecting the implementation of these relevant legislative provisions in the target SGC countries. To accomplish this, I mostly rely on primary sources of information, such as legislative and non-legislative acts, newspaper articles, organisational research reports and qualitative elite-interviews.

It is also important to note that, rule adoption is a continuous process. This is especially relevant to Georgia, who has only recently signed an Association Agreement with the EU, contracting to implement EU legislation domestically. Nevertheless, the speed and the depth of implementation are just as important as the signature of the AA. In order to glean the views of the relevant policy actors on the willingness of rule implementation, I use elite interviews also as a method of collecting data related to rule adoption (i.e. *expected effect*).

II. In the second tier the main explanatory argument and theoretical framework of this PhD will guide the investigations. In this regard, External Incentive Model allows to operationalise the *logic of calculus* in empirically observable independent factors. As indicated in the previous section, EIM predicts that, "*A government adopts the EU rules if*

[147] In order to improve my skills in understanding the EU legislation, I have undertaken a specialised 46 hours training course on the "EU gas market regulation", organised by the Florence School of Regulation, European University Institute, 2015.

[148] Wade Jacoby, *Priest and Penitent: The EU as a Force in the Domestic Politics of Eastern Europe* (NCEER, The National Council for Eurasian and East European Research, 1999).

the benefits of EU rewards exceed the domestic adoption costs".[149] In doing so, the model identifies the following 3[150] factors as its main independent factors:

1. Size and speed of reward,
2. Credibility of conditional threats and promises,
3. The role of veto players and net adoption costs.

When applied to the analysis of the success and/or failure of the rule adoption in the SGC countries, these factors, allow me to support the explanatory argument of this thesis in a "*causes-of-effects*" relationship. In investigating the role of domestic adoption costs, I take advantage of counterfactual discussions based on the rational-choice logic in the case-study chapters; against the failure of rule adoption (fact), how would the success of rule adoption (counter-fact) affect the attainment of national interests of the SGC countries concerned, assuming that they are rational utility-maximisers. Although, the similar research designs envision structured and logically sequenced phases, which is (mostly) pertinent to *quantitative* research methodology,[151] research techniques that I use for data collection and data analysis are *qualitative* and do not require any quantitative modelling. This is conditioned by the following major factors.

Firstly, quantitative data collection (*e.g.* questionnaires) or data analysis (*e.g.* statistical regression, content analysis, etc.) methods would not be effective, as the policy domain under investigation here is fairly *elitist*. In each of the case study countries (except in Turkey), only few public officials or private stakeholders are engaged in the policy-making related to the harmonisation of the domestic rules with the EU natural gas *acquis*. Therefore, insufficient number of responses would not justify the results of quantitative data collection and analysis. Quite incidentally, I was warned about this problem, albeit in a slightly different context, by a key European Commission/DG Energy official, who told me that there are very few officials in the Azerbaijani government who understand the nature of the legal arrangements with the EU, including those related to natural gas.[152]

Secondly, even if the number of participants could be extended to include general public figures (including scholarly community), elitist nature of the subject matter would not

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149 Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 12.

150 In fact, the EIM predicts the "determinacy of the rules" as the fourth independent factor. However, since the EU rules in natural gas sector are very determinate and formalised in legislative documents, this factor is less relevant to the analysis of the research, thus, will not be utilised in this PhD.

151 See e.g. Piergiorgio Corbetta, 'Quantitative and Qualitative Research', in *Social Research : Theory, Methods and Techniques*, ed. by Piergiorgio Corbetta (London; Thousand Oaks, Calif: SAGE Publications, 2003), pp. 30–56 (p. 38).

152 Interview with the European Commission/DG Energy official, 03/05/2013, Brussels.

allow to capture the political and economic sensitivities involved in the *time* and *depth* application of the EU rules in the individual SGC countries. Additionally, since energy is intrinsically politically sensitive topic, even those involved in the relevant policy-making domain would be unlikely to be always frank in their answers to standardised questionnaires forms. This, consequently, would decrease the quality of the collected data and run the risk of rendering the entire quantitative analysis distorted.

Last but not least, highly standardised techniques of the quantitative methods would not allow capturing the locally specific aspects of the factors affecting the rule adoption during both data collection, as well as analysis.

At this point, it is also very important to point out that, although the EIM envisages deductive research plan, I will leave enough flexibility in my data collection and analysis techniques in order to capture individual particularities in each empirical case without being biased by the theoretical modelling. This is also commanded by the fact that, a great deal of information in this subject area is not public and therefore, it is virtually impossible identify all the *causes* of the *effects* during the research design phase and test it in an empirical manner. For these reasons, although the causal factors (determining the adoption/rejection of the EU rules) envisaged by the EIM will guide the research process in broad strokes, I leave enough flexibility in order to complement them *inductively* during the empirical research.

In terms of the research methods, I rely on the *"three fundamental actions underlying the techniques of qualitative research",* namely, *"observing, asking and reading"*.[153] I will briefly outline these methods below, however, their detailed description will be provided in the APPENDIX I of the thesis.

Firstly, personal *observation* of the main policy developments is key for understanding the mechanisms of rule transfer from the EU to the SGC countries[154] and its general effectiveness, which cannot necessarily be captured in the formal documents (such as meeting minutes, reports, etc.). In this regard, the multilateral track of rule transfer of the Eastern Partnership, especially, the Euronest parliamentary assembly provides an accessible avenue for the observation of the discussions among the members of the European Parliament and the EaP countries.[155] Furthermore, bilateral track of the EaP,

[153] Piergiorgio Corbetta, 'The Use of Documents', in *Social Research: Theory, Methods and Techniques*, ed. by Piergiorgio Corbetta (London; Thousand Oaks, Calif: SAGE Publications, 2003), pp. 287–309 (p. 287).

[154] Rule transfer to Turkey is an exception in this case, as it is carried out in a bilateral and restricted manner. The meetings cannot be attended by the member of the general public or academia.

[155] I have attended the *sixth* and *seventh* meetings of the Energy Committee of the Euronest Parliamentary Assembly on 12/02/2014 and 04/11/2014 respectively, which took place at the European Parliament in

which is carried out in the Partnership and Cooperation Agreement (PCA) committees between the EU and the EaP countries, provides a more intimate avenue for observation and collecting data on the discussions related to rule transfer to the EaP countries and the individual positions of the receiving countries. I attended the EU-Azerbaijan PCA sub-committee on energy, transportation and environment on 11/02/2014 in Brussels/Belgium, which allowed me to glean the views of the sides and understand the nature of bilateral discussions on energy. Last but not least, since a great deal of policy debates take place in the public domain in Brussels/Belgium, I spent several months in Brussels in order to interact with the relevant public officials and the policy discourse they carry out. In doing so, I conducted a *passive observation* in order not to affect the observed social phonemenon and took on-the-spot notes.

Secondly, I conducted elite-interviews with relevant official figures involved in the negotiations of different aspects of the SGC. In total, I carried out 16 semi-structured interviews.[156] The questions of the interviews were organised around the *factors* that this thesis seeks to attribute the institutional outcome, although the order of questions and precise formulation varied from interview to interview. This was conditioned by the different context in each empirical study and the specialised focus of each interviewee. Most of the interviewees authorised me to record the interview, which were later transcribed for use in this research.[157] Elite interviews served both as a tool of data collection, as well as analysis, for the interviews were conducted in a argumentative manner.

Finally, analysis of formal documents, which were produced by legislative and executive institutions, non-governmental organisations, agencies and companies and other institutions were used for data collection and analysis purposes. In addition, secondary sources, such as journal articles and books were also utilised.

Wherever possible, I have used different techniques in conjunction in order to cross-validate the issues discussed. In using these methods, the goal of my analysis was *inference*, guided by the logic of the theoretical framework of this research. It is also important note that, this *logic of consequences* - calculus rationality of the actors and their preferences to maximise their benefits, is not the only logic in social sciences that provide predictive assumptions. As noted above, another pertinent model in Europeanisation

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Brussels/Belgium. In addition, I observed the fourth meeting of the same committee, which took place on 12/02/2013 via live public broadcasting.

[156] See APPENDIX II.

[157] Each and every interview provided me with an *interview consent form* in order to comply with the research ethics norms of the Department.

literature - *Social Learning Model (SLM)* - assumes the *logic of appropriateness* and postulates that, "*A government adopts EU rules if it is persuaded of the appropriateness of EU rules".*[158] Although the use of elite interviews helped me identify the validity of either logic, it could also be cross-validated using the comparative analysis.

For example, if the rejection of the EU rules in natural gas sector is argued to be conditioned by the logic of appropriateness, as opposed to logic of consequences, then arguably the same logic should also apply to rule adoption in other similar sectors, e.g. renewable energy generation, electricity sector or legislation related to energy efficiency. To put it in a perspective, if Turkey voluntarily adopts the EU rules in renewables or energy efficiency despite the lack of progress in accession negotiations, while the same voluntary progress is not observed in natural gas sector, then the logic of appropriateness fails to explain the underlying reasons thereof. This is especially valid given the fact that EU rules both in gas and renewables/energy efficiency spheres are made according the same legislative procedure and envision market-based production and supply of energy. Therefore, I will use this comparative technique wherever possible in order to cross-validate the logic of calculus underpinning the theoretical framework of this research.

8. Conclusion

As illustrated above, the main focus of this thesis is to investigate the regulatory elements of the development of the SGC, which can have significant impact on the competitive supply of natural gas to the EU. As such, the institutional dimension of the SGC is concerned with the establishment of the (market) rules of natural gas transportation via this energy corridor, which is aimed at addressing transit and supply risks in natural gas provision. This is especially relevant with regard to the SGC, as the natural gas volumes that the EU is trying to reach out to in the Caspian Basin and the Middle East, will have to traverse multiple jurisdictions and be subject to multiple regulatory regimes and practices before reaching the EU borders. This makes natural gas, to be supplied via this corridor, vulnerable to numerous economic and political challenges during the transit and entail geopolitical and energy security concerns. Therefore, this chapter argued that, in line with the EU's conception of energy security, which is the *diversity of energy supplies under competitive market conditions* – the institutional elements of the EU's SGC strategy aims at liberalising and depoliticising future natural gas supply via this corridor and make it subject to market rules.

[158] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 18.

Against this backdrop, this chapter indicated that the policy actions taken by the EU in order to address transit challenges envisages EU external energy governance vis-à-vis the SGC, which aims at the Europeanisation of the regulatory regime of this alternative energy corridor. The rationale of these policy actions is better captured by the theory of RCI, as it accounts for the role of formal institutions based on the *logic of consequences* (rational-choice). From the viewpoint of the SGC, RCI presents a strategic outlook of energy relations. This is rather because the *regulatory* dimension of the SGC is underpinned by the *logic of calculus.* It is geared towards addressing the external energy supply risks from and/or through third countries by expanding the boundary of the EU institutions (relevant energy *acquis*) to absorb the SGC countries and hence, take advantage of their problem-solving properties.[159] The deployment of the EU institutions externally will allow the Union to determine the parameters (rules) that condition the capacity of third countries to make energy related strategic decisions along the SGC and tailor them to the EU preferences (i.e. *free-markets*).

The EIM as the first-order adaption of RCI, additionally, provides a tailor-made analytical tool to explain the role of the domestic factors in affecting the adoption of EU rules by the target countries along the SGC, namely, Turkey, Georgia and Azerbaijan. Indeed, both RCI and EIM better engage with the research questions and help to assess the explanatory argument of this thesis, which posits that - *in the absence of the EU membership prospects or the lack of membership aspirations, net domestic adoption costs in the target SGC countries serve as the inhibiting factors of energy Europeanisation of the SGC countries.* This, accordingly, will allow me to link the energy Europeanisation of the SGC countries to their (energy and non-energy related) domestic constraints, as opposed to ***external*** (regional) factors and to the ***legitimacy*** concerns of the state actors along the SGC as currently argued by the existing academic literature.[160]

It is also important to acknowledge that, in itself this PhD is not an attempt to study the Europeanisation of Turkey, Georgia and Azerbaijan in general terms, although it borrows extensively from this subject field and empirically contributes to some of the theoretical and conceptual issues from energy security viewpoint. My main purpose in doing so is rather to utilise existing policy and theoretical tools in investigating the future EU gas supplies via the SGC under depoliticised free-market conditions.

In order to accomplish my research goals, Chapter II presents the SGC in infrastructure (hardware) terms and provides a historical overview of the developments that have taken

[159] Lavenex, 'EU External Governance in "Wider Europe"', p. 694.

[160] Pardo Sierra, 'A Corridor through Thorns: EU Energy Security and the Southern Energy Corridor'; Pardo Sierra, 'No Man's Land? A Comparative Analysis of the EU and Russia's Influence in the Southern Caucasus'.

place also during the writing of this thesis. Chapter III presents a detailed analysis of the regulatory dimension of the SGC and investigates the major avenues and the EU policy initiatives that are designed to underpin the expansion of the EU *acquis* to non-EU actors. The chapter will also analyse the specific elements in the EU energy legislation that are most relevant to eliminating transit and supply risks along the SGC. These elements will serve as benchmarks for comparatively describing the success or the failure of the EU's external energy governance in Chapters IV, V and VI (in other words, whether the SGC countries and natural gas infrastructure projects are in compliance with the EU *acquis* or not).

Accordingly, empirical chapters IV, V and VI comparatively analyse the outcome of the EU's external energy governance towards Turkey, Georgia and Azerbaijan (main non-EU countries along the SGC), with the aim to reveal the factors facilitating or inhibiting the success thereof. In doing so, each of these chapters investigate the transit and supply risks along the relevant transit country and analyse it in the context of the competitive natural gas supplies to the EU and the general success of this policy initiative. Finally, the Conclusion of the thesis sums up the core findings.

CHAPTER II: THE HARDWARE DIMENSION OF THE SGC & THE DIVERSITY OF THE EU ENERGY SUPPLIES

1. Introduction

In the previous chapter, I noted that the *hardware dimension* of the SGC is aimed at the development of physical infrastructure in order to reduce the vulnerability of the EU natural gas provision. As such, the practical role of the development of the physical infrastructure is to diversify supply sources and routes towards the Caspian Basin and the Middle East and accordingly, allow the EU to address the pre-existing gas supply risks largely stemming from a high dependence on Russian gas supplies.

Against this backdrop, the latest developments put the initial volumes to be delivered to the EU in 2020 via the SGC at only 10 bcm/a, which was highly praised by the EU as a "*major milestone for the diversification*".[161] These volumes are to be transported to the EU via a combination of SCPx, TANAP, TAP and IGB pipelines. This is less than the third of the volumes (31 BCM/year) envisioned to be supply to the EU by the original design of this alternative energy corridor (Nabucco *classic* pipeline) and roughly 2% of the current EU consumption. This has raised doubts about the ability of this fourth gas corridor to deliver tangible contribution to the EU's gas supply security. Secondly, unlike the original vision, which aimed at easing supply concentration in Central and Eastern Europe, the current contractual arrangements along the SGC will see most of the new volumes flow into the South European markets, raising questions about the *strategic deviation* of the SGC from the original blueprint. Thirdly, the supply source diversification constituted the major strategic rationale and the key selling point of the original fourth gas corridor blueprint. In contrast, the latest contractual arrangements will see only Azerbaijani reserves to be linked up with the SGC up until 2020. This raises certain concerns about the deliverability of the SGC in terms of supply diversification.

Taking stock of the latest developments, which took place during the writing of this thesis, this chapter aims to present historically up-to-date discussions on the physical establishment of the SGC, which has yet to be systematically analysed by the academic

[161] 'EC, Gas from Azerbaijan: Commission Welcomes Final Investment Decision to Extract Gas Pledged for Europe, Press Release - IP/13/1271', 2013.

literature. As such, this is relevant not only in terms of analysing the tangible (material) contribution of the SGC to reducing the pre-existing vulnerability of the EU supplies, which I accomplish in this chapter. This will also allow me to analyse, in the following chapters, the interrelations between the EU rules (regulatory dimension) in the non-EU SGC countries and the physical infrastructure (hardware) that is currently being built as part of the SGC, hence ensuring the competitiveness of the EU natural gas supply via this energy corridor.

Indeed, in contrast to other fuel types, the transportation and the very existence of *market(s)* in natural gas is heavily dependent on fixed infrastructure, especially pipelines. This affects not only the practical flow of energy, but also the application, implementation and consequences of the development of the markets rules (institutions) in natural gas sector, for the rules get practically expressed in the functioning of the relevant infrastructure. Hence, in order to translate the broader abstract assumptions of the institutional elements of the SGC into the practical implications later in this thesis, separate analysis of the *hardware dimension* of the SGC is vital.

In general, academic literature tends to reduce the SGC to the development of certain standalone transit pipelines, such as Nabucco, Trans-Adriatic Pipeline (TAP), Trans-Anatolian Pipeline (TANAP) and South-Caucasus Pipeline (SCPx). However, the regional integration of national markets has long been promoted by the EU via multiple initiatives, such as, INOGATE programme, Baku Initiative and Eastern Partnership. These initiatives have always put the emphasis on both physical integration of the national transmission networks, as well as the regulatory harmonisation of the rules operating them. If implemented successfully, this would incorporate the national markets of the non-EU countries with the single EU energy market and establish an intercontinental energy network operating under harmonised rules made in the EU.

In fact, currently some volumes of Caspian gas are already being delivered to the EU via the Turkish national transmission network and its interconnection to the Greek network via the Interconnector-Turkey-Greece (ITG). Although arguably this will likely to play relatively modest role in the future gas deliveries to the EU from the Caspian Basin and the Middle East, the integration of the national markets along the SGC will transform them into integral parts of this alternative supply corridor. Hence, in a mid-to-long term, the analysis of the SGC should concentrate on the integration of the national transmission networks.

Nonetheless, since the physical integration of the national transmission networks of the non-EU countries along the SGC is at their early stage, I will mainly concentrate on the

standalone transit pipelines that will delivery Caspian gas to the EU starting from 2020 and onwards (see **Fig. 2**).

Fig. 2: Southern Gas Corridor in physical infrastructure terms | EC, PCI interactive map, 2015

With all these in mind, below I will first locate the SGC within the context of the current EU natural gas supply vulnerability, which is caused by the over-reliance on concentrated natural gas supply sources. Then I will move on to investigate the development of the SGC in several stages, before empirically analysing its prospective contribution to reducing EU natural gas supply vulnerability.

2. EU natural gas supply vulnerability and the SGC

The European Union is a group of consumer countries whose demand in natural gas is largely and increasingly met by external supplies. Already highly dependent on energy imports, according to the European Commission, the EU import dependency in natural gas is expected to increase from the current 61% to 86% in 2035.[162]

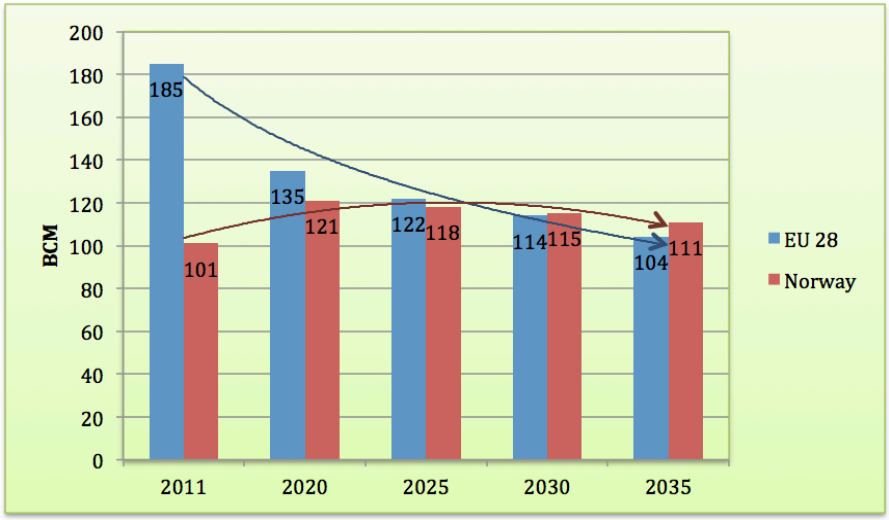
In the past, the expectations of the growing import dependency was associated with the EU natural gas demand growth forecasts, from 508 bcm/a in 2009 to 629 bcm/a in 2035.[163] Contrary to the International Energy Agency's (IEA) forecasts of "Golden Age of Gas", however, the EU gas demand in 2013 declined by 70 bcm to 438 bcm/a, compared to the 2009 gross consumption.[164] In its revised 2013 World Energy Outlook, the IEA concluded that, underpinned by sluggish economic development, cheaper coal and

[162] 'Energy Infrastructure Priorities for 2020 and Beyond - A Blueprint for an Integrated European Energy Network, COM(2010) 677' (European Commission, 2010), p. 21.
[163] *World Energy Outlook 2011* (Paris: IEA, International Energy Agency, 2011), p. 159.
[164] 'BP Statistical Review of World Energy June 2014' (BP, 2014).

increased use of renewables, gas demand in Europe will struggle to return to 2010 levels by 2035.[165]

At first glance, declining demand for natural gas should resolve the fears of high energy import dependency in the EU. However, although demand growth for energy has stabilised, the indigenous supply of natural gas has been experiencing continuous decline in the EU. The IEA forecasts that the EU domestic gas production will decline from 185 bcm/a in 2011 to 135 bcm/a in 2020 and further to 104 bcm/a in 2035. Norwegian (non-EU but EEA) supplies, on the other hand, will only increase from 101 bcm/a in 2011 to 121 bcm/a in 2020 and back down to 111 bcm/a in 2035. Under these forecasts, in 2020, the year when the SGC is to delivery first volumes to the EU, the Union would experience 50 bcm/a indigenous production decline, while increased production from Norway will be able to compensate it only by 20 bcm/a. Furthermore, in 2035 this gap in the EU demand and Norwegian production growth will only increase even further. (*see* **Fig. 3**)

Fig. 3: Natural gas production in the EU and Norway | IEA, New Policies Scenario, 2013 (bcm/a)[166]



These factors indicate geological risks that the EU might face in the future as regards to its domestic energy supply. As the EU's indigenous production (and obscure future of unconventional - shale gas production[167] and further nuclear phase-out) will not be able to take up the strain, the demand in the EU will have to be satisfied by swelling imports, which suggests escalating import dependency that is to come about in the next few

[165] *World Energy Outlook 2013* (Paris: International Energy Agency (IEA), 2013).

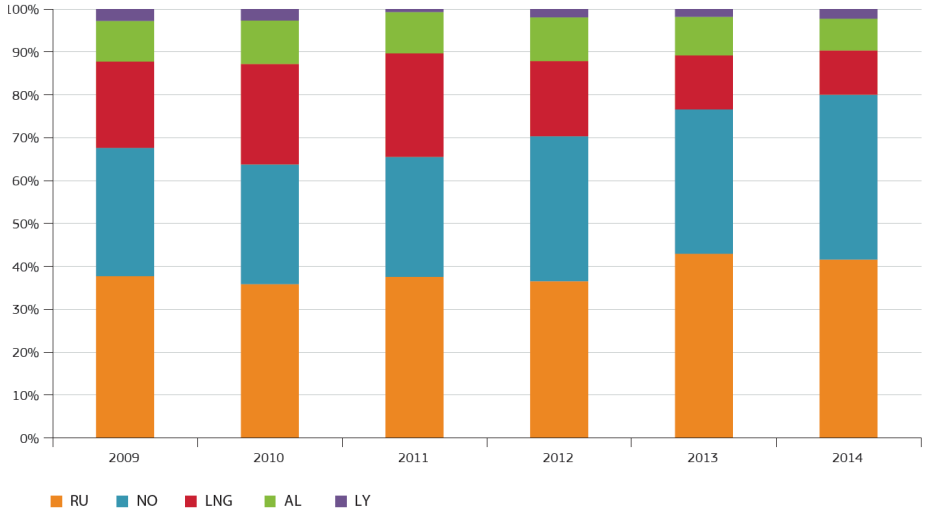
[166] *World Energy Outlook 2013*, pp. 108–109.

[167] EU will produce only around 20 bcm/a of shale gas in 2035. However, even these modest hopes on unconventional gas are waning fast due to the unfavourable geological conditions in Europe, as well as popular opposition (to controversial fracturing techniques used in the production of unconventional gas) in the EU member states. See, *World Energy Outlook 2013*, p. 118.

decades. Additionally, as the EC stresses, gas will gain further importance as the most preferable back-up fuel for the intermittent renewable electricity generation.[168]

This statistics, however, is not an indication of shortage of global gas production. To say the least, Russia is expected to ramp up its production from 673 bcm/a in 2011 to 808 bcm/a in 2035.[169] This increase would in principle be sufficient to meet Russia's growing domestic demand, as well as compensate declining EU production. However, this would also mean that the import dependency of the EU on Russian gas would only further increase. This has already been witnessed in the past couple of years, owing to the reduced LNG deliveries (higher prices in Asia and Latin America attracted most of the world LNG shipments), declining indigenous production and reduced imports from Algeria and Libya. As a result, in 2014, Russian gas made up around 42% of the EU imports (See **Fig. 4**).

Fig. 4: EU imports of natural gas by source, 2009-2014 | EC, 2015[170]



However, what is invisible in Fig. 4 is the asymmetrically high dependence of the Central and South-Eastern EU member states on a concentrated source of supply, i.e. Russia. As the table below illustrates, these countries receive a bigger share of their imports, as well as consumption from Russia compared to the Western EU countries. This is largely due to the lack of immediate alternative natural gas supplies to the region and special historical relations that these countries had shared with Russia (USSR) in the past.[171] The combination of these factors has eventually lead to above 60-70% import dependency on Russian gas (see **Table 2**).

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168 'Energy Infrastructure Priorities for 2020 and Beyond - A Blueprint for an Integrated European Energy Network, COM(2010) 677', pp. 6–7.

169 *World Energy Outlook 2013*, p. 109.

170 *Quarterly Report on European Gas Markets* (Brussels: European Commission, Directorate-General for Energy, Market Observatory for Energy, 2015), p. 8.

171 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781', p. 4.

Table 2: Dependence of EU member states on Russian natural gas imports | IEA, Natural Gas Information, 2013 *(compiled by author)*

EU Member States	Consumption *(bcm/a)*	Total Imports *(bcm/a)*	Total Exports *(bcm/a)*	Imports from Russian Federation *(bcm/a)*	Share of Russian gas in total imports *(%)*	Share of Russian gas in total consumption *(%)*
Austria	9.038	11.551	3.751	8.264	72%	91%
Belgium	17.937	21.126	4.446	0.000	0%	0%
Bulgaria	2.742	2.488	0.000	2.488	100%	91%
Croatia	3.023	1.357	0.150	0.400	29%	13%
Czech Republic	8.323	7.471	0.000	7.468	100%	90%
Denmark	3.899	0.255	2.985	0.000	0%	0%
Estonia	0.670	0.670	0.000	0.670	100%	100%
Finland	3.671	3.671	0.000	3.671	100%	100%
France	44.147	45.218	2.480	7.102	16%	16%
Germany	87.201	87.742	18.127	31.351	36%	36%
Greece	4.354	4.510	0.000	2.700	60%	62%
Hungary	10.232	8.173	0.836	3.576	44%	35%
Ireland	4.737	4.362	-	0.000	0%	0%
Italy	74.915	67.725	0.139	18.999	28%	25%
Latvia	1.508	1.720	0.212	1.720	100%	114%
Lithuania	3.364	3.322	0.000	3.322	100%	99%
Luxembourg	1.214	1.210	-	0.290	24%	24%
Netherlands	45.988	26.088	60.409	2.931	11%	6%
Poland	18.112	12.246	0.000	9.773	80%	54%
Portugal	4.629	4.594	-	0.000	0%	0%
Romania	13.560	2.888	0.000	2.488	86%	18%
Slovak Republic	5.289	4.801	0.000	4.779	100%	90%
Slovenia	0.872	0.870		0.393	45%	45%
Spain	32.496	35.062	2.795	0.000	0%	0%
Sweden	1.130	1.130		0.000	0%	0%
UK	78.083	50.259	13.111	0.000	0%	0%

In this regard, although high import dependency is not a risk for energy security in itself, the lack of import alternatives incurs a high degree of vulnerability. Vulnerability here refers to the geographical concentration of supply sources and transit routes on a single country or region.[172] In this regard, if a country relies on a concentrated supply source, its

[172] Javier García-Verdugo and Beatriz Muñoz, 'Energy Dependence, Vulnerability and the Geopolitical Context', in *Energy Security for the EU in the 21st Century: Markets, Geopolitics and Corridors*, ed. by José María Marín Quemada, Javier García-Verdugo, and Gonzalo Escribano (London; New York: Routledge, 2012), pp. 37–53 (p. 41).

energy system will become more vulnerable, as it is more difficult to compensate e.g. the loss of a source that accounts for 40% of supplies than the 10% one.

On the one hand, risks associated with energy vulnerability can be geopolitical, for high dependence on a single source/transit route can make the consumer countries vulnerability to the political blackmailing by the supplier(s), which has largely been ascribed to the behaviour of Russia during the EU gas supply cuts in 2006 and 2009. On the other hand, the energy vulnerability can entail other risks, not all of which are conditioned by (geo)political considerations, such as *geological* (exhaustion of indigenous reserves), as well as *technical* (failure of supply systems, triggered by environmental calamities and human error).[173] In a relatively recent example, several EU countries, namely, Poland, Slovakia, Austria, Hungary, Bulgaria, Romania, Greece and Italy experienced gas supply shortages from Russia due to the cold snap sweeping across Europe during the winter of 2012. Cold weather temperatures resulted in increased domestic consumption in Russia while leaving the country with less export capacity.[174] In another example, in 1986 Britain lost one quarter of its total energy supplies for several days due to the strike of Norwegian offshore workers.[175] A similar strike hit Norwegian oil and gas industry during the summer 2012, which caused considerable oil price hikes around the world and threatened natural gas supplies to the EU. In itself Norway is probably the most reliable natural gas supplier to the EU. Nonetheless, the mentioned strike endangered supplies to the UK, Netherlands, France, Germany and several other countries.[176] Hence, although unexpected supply shortages from Russia have largely been attributed to the political motivations in the Kremlin, not all disturbances in gas supply are of geo-political nature.

As such, non-existence of geopolitical risks on the supply side must not be considered as a benchmark for security of supply, for one can never predict the potential risks, which can be incurred for a variety of reasons. The upshot is that, whether strategically conditioned or unmeditated, the interruption of gas supplies has security of supply implications for the

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173 See e.g. Arianna Checchi, Arno Behrens and Christian Egenhofer, *Long-Term Energy Security Risks for Europe: A Sector-Specific Approach* (CEPS, 2009), p. 3; Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalisation*; Jonathan Stern, *The New Security Environment for European Gas: Worsening Geopolitics and Increasing Global Competition for LNG* (Oxford: Oxford Institute for Energy Studies, 2006); Javier García-Verdugo and San-Martín Enrique, 'Risk Theory Applied to Energy Security: A Typology of Energy Risks', in *Energy Security for the EU in the 21st Century: Markets, Geopolitics and Corridors*, ed. by José María Marín Quemada, Javier García-Verdugo, and Gonzalo Escribano (London; New York: Routledge, 2012), pp. 111–43.

174 'Europe Hit by Russia Gas Shortage', *BBC*, 4 February 2012, section Europe <http://www.bbc.co.uk/news/world-europe-16883560> [accessed 20 December 2012].

175 Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalisation*, p. 16.

176 'Norway Government Ends Oil Strike', *BBC*, 9 July 2012 <http://www.bbc.co.uk/news/business-18767000> [accessed 21 October 2012].

consumer countries, especially if it is experienced from the single biggest gas supply source. Supply vulnerability, on the other hand, is reduced by diversifying supply sources and transportation routes. The more the number of suppliers and the less the share of individual supplies, the less vulnerable the energy system will be to supply cut-offs.

In this regard, diversity should be viewed as a measure of security. If the EU member states are well interconnected, diversity of supplies will ensure that if one or several supply sources are gone offline - regardless of underlying reasons - the rest can compensate the lost supplies by filling the gap.[177] Vis-à-vis geological risks to energy supply, on the other hand, diversification will ensure that declining domestic production can be supplemented by new sources, without increasing concentrated imports from the existing ones.

Against this backdrop, the establishment of the fourth gas (pipeline) corridor has topped the EU's energy agenda in the past decade. This, so called, Southern Gas Corridor is to link gas production sites in the Caspian Basin (Azerbaijan and Turkmenistan) and the Middle East (Iraq and Iran) with the European consumers.[178] I have argued in the previous chapter that, the SGC strategy of the EU is rather multidimensional, for it includes both *hardware* and *regulatory* (software) elements.

The *hardware* dimension of the SGC is aimed at the development of physical infrastructure in order to physically link the Caspian Basin and the Middle East with the EU market(s). Although the development of physical infrastructure is intrinsically linked to the development of formal rules governing them, the two should be investigated separately in order to unearth their contribution to different objectives of the EU's conception of *energy security* (which includes both *diversity* and *competitiveness* of energy supply).

With these in mind, I look into the physical development of the SGC in 3 historical stages: a) the rise and fall of the Nabucco classic pipeline; b) TANAP and the access to the Caspian; 3) TAP as the final home stretch (see **Fig. 2**). Finally, I will quantitatively describe the prospective role of the SGC in reducing the supply vulnerability of Bulgaria, Greece and Italy (the future buyers of the initial gas volumes from Azerbaijan) on Russian gas imports.

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[177] Interview with the key official of the European Commission/DG Energy, 03/05/2013, Brussels. For a similar argument, see also, Buchan, *Energy and Climate Change: Europe at the Crossroads*, p. 13; 'The Commission's Energy Infrastructure Package, MEMO/11/710' (European Commission, 2011).

[178] 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781', pp. 4–5.

3. The first stage of SGC: rise and fall of Nabucco classic

Initiated as early as 2002, no pipeline has topped the EU's political agenda so continuously and vigorously in the past decade as the Nabucco *classic* pipeline.[179] The first talks about the pipeline started between Austrian energy company OMV and Turkish national champion BOTAŞ back in 2002. Soon joined by Hungarian MOL, Bulgarian Bulgargaz, Romanian Transgaz, the five companies concluded a protocol in June 2002 declaring their intention to construct a pipeline between Turkey and Austria. The Cooperation Agreement on the pipeline was signed on October 10, 2002 in Vienna, which followed by the partners attending the Vienna State Opera to watch "The Nabucco" opera by Giuseppe Verdi, to which the pipeline is beholden for its name.[180] Nabucco International GmbH was established on June 24, 2004 and was seated in Vienna, Austria, although it took another 5 years - July 13, 2009 - to sign the Intergovernmental Agreement (IGA) among the transit countries.

At the early stages of the pipeline planning Nabucco *classic* saw little or no support from the European heavyweights like Italy and Germany, as they were quite comfortable with their bilateral deals signed with Russian Gazprom and had access to other supply sources. Therefore, Germany and Italy were less willing to antagonise Moscow by getting in direct deals with former Soviet satellites while bypassing Russia.[181] Quite the opposite, German centre-left chancellor Gerhard Schröder put his political weight behind the Russian Nord-Stream pipeline that directly linked Russian Baltic coast with Germany, thus avoiding transit jurisdictions of third countries.[182] However, with 80% of Russian gas exports to the EU being transmitted via Ukrainian gas transmission system (GTS), the consecutive Russian gas cut-offs across Ukraine in 2006 and 2009 and the Russian invasion of Georgia in 2008 served as a wake-up-call to the Europeans about the vulnerability of supply dependence on a single source and route.[183] This constituted a good reminder for the EU

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[179] The original pipeline was called only Nabucco. However, since it saw a revision in its architecture at a later stage, the original pipeline came to be known as Nabucco Classic, while the new version was recognised as Nabucco West.

[180] Bülent Aras and Emre Iseri, *The Nabucco Natural Gas Pipeline: From Opera to Reality*, (SETA Policy Briefs) (SETA Foundation, 2009), p. 4.

[181] Erdogdu, 'Bypassing Russia: Nabucco Project and Its Implications for the European Gas Security', p. 2942; Katinka Barysch, 'Should the Nabucco Pipeline Project Be Shelved?' (Transatlantic Academy, 2010), p. 7.

[182] Daniel Freifeld, 'The Great Pipeline Opera', *Foreign Policy*, 24 August 2009.

[183] Freifeld, 'The Great Pipeline Opera'; see also, Paul Belkin, Jim Nichol and Steven Woehrel, *Europe's Energy Security: Options and Challenges to Natural Gas Supply Diversification* (DC, Washington: Congressional Research Service, 20 August 2013), p. 12.

countries that the diversification of energy supply was a matter of energy and consequently, economic and political security.[184]

These events followed by the European Commission identifying Nabucco as a project of common interest in its Second Strategic Energy Review.[185] The pipeline saw another push when the German RWE joined Nabucco and became an equal shareholder with 16.7%, while later in 2010 the European and International financial institutions promised up to 4€ bln in loans to the project conditional upon Nabucco meeting solid project financing requirements.[186]

3.1. Conceptual architecture of Nabucco classic: what did it offer?[187]

To be built by the buyers and the transit countries - *intermediaries* - Nabucco Classic was the "merchants' pipeline", the practice widespread in the USA but relatively unknown in Europe. The concept envisioned a degree of sophistication and well-planning by the intermediaries so as to be able to recover the costs of construction, as well as the operation of the pipeline, while supported by tariffs that offer commercial terms that attract both suppliers and consumers.[188]

Conceptually, the project was expected to work under a *one-stop-shop* principle and any company that wanted to use the pipeline only had to deal with only a single interlocutor – Nabucco International GmhB – in order to supply gas from Eastern Turkey to the Austrian hub in the EU or vice versa.[189] This would spare the prospective shippers of all the political and economic hassles incurred by different regulatory regimes in force in different Nabucco host countries.

Access regime to the pipeline was to be based on the "open seasons procedure" with fixed tariff methodology and consisted of two stages. In the first stage, the pipeline shareholders had the right to reserve the 50% capacity - up to 15BCM for their own use (supported by the derogation from the EU third party access (TPA) requirement for 25 years). In the

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184 See e.g. Aleksandar Kovacevic, *The Impact of the Russia-Ukraine Gas Crisis in South Eastern Europe* (Oxford: Oxford Institute for Energy Studies, 2009).

185 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781'.

186 Anthony Williams, 'EBRD, EIB and IFC Start Appraisal of Nabucco Pipeline: Important Step Towards Meeting Europe's Energy Security Demands' (EBRD, 2010) <http://www.ebrd.com/pages/news/press/2010/100906.shtml> [accessed 21 April 2014].

187 Although the IGA on Nabucco was signed with a period of 50 years, and did not include any clause of termination if the pipeline is not built, I will still use past tense in explaining different elements of Nabucco pipeline.

188 John Roberts, 'The Southern Corridor: Baku-Tbilisi-Ceyhan's Gas Legacy', *Turkish Policy Quarterly*, September 2012, 77–85 (pp. 79–80).

189 'President Barroso and Commissioner Piebalgs Welcome the Signature of the Nabucco Intergovernmental Agreement, Press Release, - IP/09/1114'.

second step, however, the remaining capacity of the pipeline had to be offered to all other market participants, including the shareholders, on equitable bases in order to create equal opportunities for all (if the technically available capacity is not booked after the second stage, a third round of open-seasons could be held).[190] In this regard, the second stage of the "open seasons" presented an *unbundled* transportation scheme, where the pipeline owners "rent the transportation capacities", both on long- and short-term bases to the interested shippers.[191] The reserved capacity, on the other, was supposed to function under *use-it-or-lose-it* (UIOLI) principle, in order to ensure that the scarce capacity is used by those who need it most.[192]

The regulatory aspects of the pipeline were probably the most important characteristics of Nabucco. Being an international pipeline Nabucco classic was expected to traverse the territories of several countries with different regulatory regimes. Although Turkey at the time was and still is a candidate country to the EU membership, it is yet to align its energy legislation with that of the EU. Therefore, the European Commission, who negotiated the Nabucco intergovernmental agreement (IGA)[193] on behalf of the EU member states, ensured that the IGA was fully in line with the EU *acquis* despite Turkey's non-EU member status. From the perspective of Turkey, as the former Turkish ambassador to the EU Selim Kuneralp put it, through the signature of the Nabucco IGA, Turkey's *"alignment with the acquis [was] coming in through the back door".*[194] With its *open seasons* and equitable and transparent access for the 50% of the capacity of the pipeline in open tender, the regulatory regime of Nabucco promised considerable alignment with the requirements of the EU energy *acquis*, which explains the strategic (albeit) insufficient support it had received form the Union.

The single interlocutor concept had a second major objective, too. With a *"harmonised capacity management system along the whole length of the Nabucco project"*, it was designed in a way that only the owners of the pipeline (the consortium of consumer with equal stakes) could control the access to and the off-take from the pipeline, without

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190 'Intergovernmental Agreement on Nabucco', 2009, Article 3.

191 Matthias Pickl and Franz Wirl, 'Enhancing the EU's Energy Supply Security—An Evaluation of the Nabucco Project and an Introduction to Its Open Season Capacity Allocation Process', *Zeitschrift Für Energiewirtschaft*, 34.3 (2010), 153–61.

192 'Intergovernmental Agreement on Nabucco', Article 3.3.2 and Annex 3; see also, Pickl and Wirl, 'Enhancing the EU's Energy Supply Security—An Evaluation of the Nabucco Project and an Introduction to Its Open Season Capacity Allocation Process', p. 157.

193 The Intergovernmental Agreement is a government-to-government agreement that declares the political commitments of the relevant governments to facilitate the development, construction and the operation of the pipeline at all stages. The Project Support Agreement (also called Host Government Agreement - HGA), on the other hand, is a contract signed between each relevant government hosting the project and the project promoter and sets out the details referred to in the IGA.

194 Interview with the Ambassador Selim Kuneralp, 10/04/2015, Brussels.

interference of the governments whose territories it was to traverse.[195] Such a strong attention by the EU to the regulatory aspects of Nabucco was (and still is) based on an *institutional* approach that the Union pursues in its relationships with third countries, which is aimed at reducing external risks by institutionalising its bilateral/multilateral relations with third-countries based on the EU legislation.

With three access points in Eastern Turkey, Nabucco classic was expected to bring 31 bcm/a gas from the Caspian basin, Iran, Iraq (see **Fig. 5**) and possibly from Egypt to the European Union.[196] These huge volumes (albeit hypothetical) could not only make additional gas available during the supply crisis, but also force dominant suppliers to offer more competitive prices, similar to that when increased LNG supplies to Europe forced Gazprom to offer price discounts to its European consumers.[197]

Fig. 5: Nabucco *classic* pipeline | Prepared by the author using publically available information.

3.2. Nabucco vs. South Stream

Nonetheless, Nabucco was not alone in targeting the South-East and Central European gas market, while trying to avoiding Ukrainian territory. From the moment of inception of

[195] 'Intergovernmental Agreement on Nabucco', Articles 7, 8.

[196] Vladimir Socor, 'Sourcing the Nabucco Pipeline to Prevail Against South Stream', *Eurasia Daily Monitor*, 8 February 2008 <http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=33365&no_cache=1#.VYhtLxOqqko> [accessed 18 April 2014].

[197] James Marson, 'Gazprom Cuts Gas Price for Poland', *Wall Street Journal*, 6 November 2012 <http://online.wsj.com/articles/SB10001424052970204349404578102230135329520> [accessed 18 November 2014].

Nabucco, the Kremlin swiftly introduced *South Stream* pipeline.[198] Dubbed by some experts as President (Vladimir) Putin's political project, it was to carry gas from Russian Black Sea coast to Baumgarten (following the Nabucco route) with an overall 62 bcm/a capacity, while bypassing troubled Ukrainian territory.

Russian pipeline offered twice the transportation capacity as the Nabucco classic. However, these two pipelines were quite different in terms of their contribution to the EU's energy diversification strategy. In this regard, Nabucco offered diversification of both supply source, as well as the transit route. It was to bring Europe qualitatively new gas volumes from the countries, which have yet to send Europe a single molecule of natural gas.[199] The route of Nabucco was selected in a way to avoid Russian territorial jurisdiction and hence, its political and economical influence and presented both source and route diversification. This would not only increase the security of European gas supply but also strengthen the EU buyers' position in negotiating gas prices with Russia.[200] South Stream, on the other hand, was only to carry Russian gas, albeit through a different route. In this vein, from the EU's perspective South Stream would only offer a route diversification, while keeping the supply source intact, hence, did not qualify as a project of European interest.[201]

According to some studies, in the case of supply cut-offs across Ukraine, South Stream would be able to better mitigate the supply disruption. This is rather because, the pipeline was to re-route Russia's EU gas exports that currently go across Ukraine. Therefore, the impact of potential Ukraine disruption would be minimised by the construction of the South Stream (and Nabucco).[202] However, since South Stream only addressed the transit dimension of the EU's natural gas supplies and did not take into account the supply source crisis, during the supply source cut-off scenarios it would have been less reliable than Nabucco.

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198 South Stream pipeline was cancelled by Russia in December 2014.

199 This is not strictly correct, as some of Azeri gas exports to Turkey are being re-exported to Greece. On the other hand, Turkmen gas has also been re-sold to Ukraine and the EU by Russia. In this regard, the major difference in the case of Nabucco is that, it will provide a single stand-alone pipeline allowing producer and consumers to engage in direct trade without the interference middlemen like Turkey or Russia. See e.g. Ingilab Ahmadov, 'The Southern Corridor and Nabucco – A Promising Challenge for Caspian Countries', in *Beyond Turkey: The EU's Energy Policy and the Southern Corridor*, ed. by Kristin Linke and Marcel Vietor (International Policy Analysis, 2010), pp. 15–19 (p. 18); Kardas, 'Turkish–Azerbaijani Energy Cooperation and Nabucco: Testing the Limits of the New Turkish Foreign Policy Rhetoric', p. 61.

200 Remme, Blesl and Fahl, 'Future European Gas Supply in the Resource Triangle of the Former Soviet Union, the Middle East and Northern Africa', p. 1637.

201 'Oettinger Says South Stream Not a Project of Common Interest', *Natural Gas Europe*, 22 September 2013 <http://www.naturalgaseurope.com/south-stream-eu-priority-project> [accessed 21 April 2014].

202 Dieckhoner, 'Simulating Security of Supply Effects of the Nabucco and South Stream Projects for the European Natural Gas Market', p. 174.

On the other hand, the starting point of South Stream was more than 3000 km away from the production sites in Yamal peninsula. Gas sold via South Stream would not only include the high costs of production in Western Siberia (due to permafrost conditions), but also the cost of construction of new domestic transmission systems towards the Black Sea coast, in addition to the cost of South Stream pipeline itself.[203] According to some studies, even if only the entry-to-exit-point distance is considered, the costs of transportation of (any) 1000/m3 of gas were to be 19% cheaper via Nabucco, as opposed to South Stream (not taking into account the extra costs of production in Russian fields).[204] Therefore, it would have been much cheaper for Russia to continue using Ukrainian and Polish transit routes, as opposed to South Stream, in order to export its gas to the EU markets. In this regard, despite certain benefits, the South Stream was only a strategic, as opposed to a cost-efficient pipeline for transporting Russian gas to Europe.[205]

3.3. Fall of Nabucco Classic

It was widely expected that the rising cost of carbon emissions in the EU would drive the demand for gas at the expense of dirty coal and fuel oil[206] and thus, increase the economic viability of great capacity pipelines like Nabucco. This, however, did not transpire in the years following the signature of the Nabucco Intergovernmental Agreement (IGM) in 2009 and hence, could not attract the necessary financial support to the now-deceased pipeline. There are several factors that made the failure of Nabucco classic inevitable.

Lack of gas supplies & transaction costs have played the primary role in the demise of the project. Many experts considered that even though Nabucco classic could remain empty at the beginning, its very existence would incentivise gas exports through this pipeline.[207] In addition, the consortium members anticipated that the wellhead-to-market cost of gas exports via Nabucco to be 15% to 27% cheaper than the competing projects (South Stream, ITGI and TAP). These calculations could well have been true, if the main

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[203] The IEA predicts the costs to be $3.47-$4.07/Mbtu from the Caspian basin to Austria across Turkey vs. $5.68 -$6/Mbtu from Russian fields across the Black Sea seabed to the same destination. *World Energy Outlook 2009* (Paris: IEA, International Energy Agency, 2009), pp. 482–484.

[204] Pickl and Wirl, 'Enhancing the EU's Energy Supply Security—An Evaluation of the Nabucco Project and an Introduction to Its Open Season Capacity Allocation Process', p. 159.

[205] Dieckhoner, 'Simulating Security of Supply Effects of the Nabucco and South Stream Projects for the European Natural Gas Market', p. 158; Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', p. 64.

[206] See e.g. Fredrik Pettersson, Patrik Söderholm and Robert Lundmark, 'Fuel Switching and Climate and Energy Policies in the European Power Generation Sector: A Generalized Leontief Model', *Energy Economics*, 34.4 (2012), 1064–73.

[207] Susanne Nies, *Oil and Gas Delivery to Europe: An Overview of Existing and Planned Infrastructures*, New Edition (Bruxelles: Paris, Les Études, 2011), p. 156.

assumption - 90% the utilisation rate - were to be held.[208] This, unfortunately, was not the case given the lack of gas supplies available to fill the pipeline. The Shah-Deniz consortium could offer only 10 bcm/a gas to the 31 bcm capacity Nabucco classic. This raised an important question about the empty capacity of the pipeline and the tariffs for transportation. According to Nabucco IGA, transportation tariffs were to be calculated based on the contracted capacity by the shipper, ***the load factor***,[209] the transportation distance, CAPEX and OPEX per capacity unit and volumes.[210] Taking the load factor into account, if a 31 bcm capacity pipeline works only with 10 bcm annual output, then the transportation costs of the entire capacity (31 bcm) has to be paid by the shipper of the 10 bcm gas in order to recover the CAPEX and OPEX of the TSO - Nabucco International GmbH, which was the opposite of the economies of scale principle.[211] In other words, since the pipeline was not going to be fully utilised, the per unit cost of transportation of Azeri gas would have increased considerably. Azerbaijani SOCAR - the marketing operator of Shah-Deniz consortium - however, was unwilling to pay for the empty capacity of the pipeline, which if passed onto the final consumers would make Azeri gas uncompetitive in the European markets. On the other hand, if these costs were to be met by the SD consortium, then the whole project would not be commercially profitable to start with, given the massive amount of upfront investment it required. FID into the SD II, on the other hand, would only be possible if the gas sales & purchase and transportation agreements were concluded before the actual start of production of gas in SD II.[212] Therefore, without additional firm gas supplies from other sources Shah-Deniz consortium was unlikely to commit 10 bcm gas and pay for the empty capacity of the Nabucco pipeline.[213] Such an arrangement would not only incur economic costs, but also dis-incentivise Nabucco consortium to find additional supplies, because they would already be getting paid for the entire technical capacity of the pipeline.[214] Obviously, Azerbaijan could, in principle, commit additional 10 bcm (20 bcm in total) gas flow, which would make Nabucco economically feasible at the beginning.[215] This, nonetheless, contradicts with

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[208] RWE GmbH, 'Nabucco: The Most Commercial Southern Corridor Gas Pipeline Project', 2009 <https://www.rwe.com/web/cms/en/239932/rwe-supply-trading/press/press-release/?pmid=4004206> [accessed 19 April 2014].

[209] Ratio between the capacity utilised by a shipper and the maximum available capacity of the pipeline.

[210] 'Intergovernmental Agreement on Nabucco', Annex 4.

[211] The economies of scale principle dictates that, the greater the volume of gas/oil transported, the lower will be the per-unit fixed costs of transportation, since the costs will shared over a larger volume of oil and gas that is being transported.

[212] This was highlighted during the interview with a senior official from SOCAR, 29/06/2015, Brussels.

[213] Without firm supply contracts, on the other hand, Nabucco was unable to security necessary financial tools from financial institutions.

[214] Rudolf ten Hoedt, '"We Do Not Want to Depend on Only One Pipeline" - Interview with Elshad Nasirov', *European Energy Review*, 2010.

[215] Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', p. 50.

Azeri (or any other supplier's) policy of diversification of demand - *why put all your eggs in one basket?*[216]

In this backdrop, several other prospective supply sources, inter alia, Iraqi reserves came to be touted as Nabucco starter, especially following German RWE's investment deal with Kurdistan Regional Government of Iraq. However, as it became clear later, the gas field that could realistically be hooked-up with Nabucco - Akkas field - was in the Baghdad controlled region of Iraq, close to the Syrian border. The major gas field in volatile Iraqi Kurdistan - Mansuriyah, on the other hand, would only make sense if linked only to the local network in order to meet local demand.[217] This meant that any gas exports from Iraq required a permanent solution to the problem of constitutional division of powers and revenue sharing arrangements between the central government and the government in the Kurdish autonomous region,[218] which have yet to materialise even after all the deadlines put for Nabucco classic, i.e. 2014. In addition, any prospects of Iraqi gas being channelled to Nabucco via the extension of the Arab Natural Gas Pipeline (running from Egypt to Syria)[219] were nipped in the bud by the Syrian civil war that has engrossed the country. The current security predicament in the entire region, exacerbated with the invasion of Iraq and Syria by the terrorist organisation called ISIS, renders any regional project unviable for at least in the next decade or so.

Last but not least, Iran - another hopeful of the Nabucco classic - is still embroiled in soft international conflict due to its nuclear programme.[220] Thus, any gas exports from Iran to the EU turned out to be an unlikely scenario. For these reasons, the Shah-Deniz consortium was less willing to risk with its economic wellbeing, while the determination of Nabucco tariffs and the overall project realisation was depended on unrealistic Iraqi gas (and just as uncertain Turkmen and Iranian gas).[221]

Hence, the merchant's model that Nabucco was based on did not take into account the upstream risks associated with construction without *ex-ante* supply commitments. As

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216 Ahmadov, 'The Southern Corridor and Nabucco – A Promising Challenge for Caspian Countries', p. 17.

217 *RWE's Kurdish Nabucco Gas Deal Spells Problems for Upcoming Iraqi Gas Licensing Round - IHS Economic Report*, 31 August 2010 <http://www.ihs.com/products/global-insight/industry-economic-report.aspx?id=106593878> [accessed 19 April 2014].

218 'Iraq Says Kurd Gas Deal with Germany's RWE Illegal', *Reuters*, 2010 <http://uk.reuters.com/article/2010/08/29/iraq-gas-rwe-idUKLDE67S05H20100829> [accessed 19 April 2014].

219 Ömer Fatih Sayan, 'Turkey's Energy Policy between East and West', in *Beyond Turkey: The EU's Energy Policy and the Southern Corridor*, ed. by Kristin Linke and Marcel Viëtor (Berlin: Friedrich-Ebert-Stiftung, 2010), pp. 10–14 (p. 13); Kardas, 'Turkish–Azerbaijani Energy Cooperation and Nabucco: Testing the Limits of the New Turkish Foreign Policy Rhetoric', p. 63.

220 Mert Bilgin, 'The Middle East – A Real Gas Option for the Southern Corridor?', in *Beyond Turkey: The EU's Energy Policy and the Southern Corridor*, ed. by Kristin Linke and Marcel Viëtor, International Policy Analysis (Berlin: Friedrich-Ebert-Stiftung, 2010), pp. 20–24.

221 Hoedt, '"We Do Not Want to Depend on Only One Pipeline" - Interview with Elshad Nasirov'.

major pipelines were traditionally built by the producers themselves, the capital expenditures incurred served as a "hostage" until the costs were recovered during the operation of the pipelines. Therefore, suppliers (who were also the builders) were incentivised to use the pipeline in order to recover their pipeline investment.[222] As Finon most eloquently put it, *"partnership from wellhead to consumers introduces mutual commitment".*[223] Nabucco, on the other hand, defied this logic and in the absence of gas supplies could not secure investment from international financial institutions and banks.

Strategic vs. commercial partnership - Some also argued that, one of the main reasons why SD consortium did not put its weight behind the Nabucco Classic was that the pipeline consortium did not represent the interests of the producers.[224] Indeed, the merchants' pipe concept did not fit with SOCAR's global expansion vision. Azerbaijan's energy strategy is quite different from that of Turkmenistan, which sells gas at the border and is more than satisfied with flowing energy rents. Quite the opposite, SOCAR is aspiring to break away from the role of a mere upstream player and step up its involvement in other segments of the global energy trade.

Azeri oil and gas reserves are far inferior to those of Turkmenistan.[225] Therefore, the government is already working on the blueprint of transforming SOCAR into a global company. To that end, SOCAR aims to get stakes not only in upstream, but also in the mid- and down-stream markets[226] (gas transportation and distribution to the final consumers with the likes of German RWE, French GDF or Total). This will allow the company to continue its business in the world markets even after the oil and gas reserves in Azerbaijan run dry, which as a matter of fact is not a distant possibility. To this end, both, the shares in the main transportation conduit, as well as the rights to sell gas to the final consumers was paramount for Azeri energy champion.[227] The decisions made then would affect the company's international standing in the next 20-30 years. In this vein, since Nabucco Classic did not offer such possibilities, Azerbaijani SOCAR never rushed into pledging gas supplies Nabucco consortium.

Lack of 'competitive' demand - Last but not least, the competitive demand in the markets to be supplied by Nabucco classic did not present an attractive option for the Shah-Deniz

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222 Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', pp. 55–58.

223 Finon, 'The EU Foreign Gas Policy of Transit Corridors: Autopsy of the Stillborn Nabucco Project', p. 58.

224 Gulmira Rzayeva and Theodoros G.R. Tsakiris, *Strategic Imperative: Azerbaijani Gas Strategy and the EU's Southern Corridor* (Baku: SAM Center for Strategic Studies, 2012), p. 16.

225 'BP Statistical Review of World Energy June 2014'.

226 Gulgiz Dadashova, 'SOCAR Confirms Plans to Enter European Gas Distribution Market', *AzerNews*, 1 July 2013 <http://www.azernews.az/oil_and_gas/56121.html> [accessed 19 November 2014].

227 Hoedt, '"We Do Not Want to Depend on Only One Pipeline" - Interview with Elshad Nasirov'.

producers.[228] In gas business, the fuel must be sold before it is actually produced. In this vein, as was elaborated on numerous occasions, Azerbaijan's supply of gas to Nabucco was more dependent on the question: Who pledges to buy 10 BCM at competitive prices, if SOCAR choses to supply gas through Nabucco?[229] The ensuing "defeat" of Nabucco West - Nabucco classic's successor (which was slated to start with an initial 10 bcm capacity and scaled up as the new supplies become available) also indicated that although the initial lack of supplies might have been the factor killing the Nabucco Classic, it was by far not the only reason. Although the markets along the route of Nabucco are heavily dependent on Russian supplies, they are not necessarily undersupplied. Hence, the Nabucco route did not present an attractive enough commercial option for the suppliers in order to push for the project realisation. No contractual commitments, on the other hand, translate into no project financing by the financial institutions.

To sum it all up, the problems present at the birth of Nabucco classic had never actually been resolved and lead to the demise of the decade-old international project. Regardless of its massive capacity and favourable to the EU regulatory regime, the failure of Nabucco served as a good indication that economics still trumps all other factors when it comes to the realisation of multi-billion projects.

4. TANAP and access to the Caspian

Following the deadlock reached in the development of Nabucco Classic, a new project surfaced along the SGC following the signature of a Memorandum of Understanding between Azerbaijan and Turkey on December 24, 2011. Owned by Azeri SOCAR (58%), Turkish BOTAŞ (30%) and BP (12%) and stretching from the East-to-Western Turkey, the new pipeline is named after the peninsular that it traverses - Trans-Anatolian Pipeline (TANAP) (see **Fig. 2**). TANAP is to replace the Turkish section of the Nabucco Classic and carry Caspian (and prospectively Middle Eastern) gas to the EU-Turkey border. On the Eastern side TANAP will be fed by the expanded version of the South Caucasus Pipeline (SCPx), which will connect the gas production sites in Azerbaijan to TANAP.

The initial capacity of TANAP is expected to be half of the size of Nabucco Classic - 16 BCM, albeit scalable to 32 bcm/a due to the 56" pipeline diameter. Initially, TANAP is expected to transport Azeri gas from the second phase of the development of the Shah-Deniz gas

[228] Although, initial survey revealed demand for Nabucco to be between 140%-460% capacity of the pipeline. See Pickl and Wirl, 'Enhancing the EU's Energy Supply Security—An Evaluation of the Nabucco Project and an Introduction to Its Open Season Capacity Allocation Process', p. 157.

[229] Hoedt, '"We Do Not Want to Depend on Only One Pipeline" - Interview with Elshad Nasirov'.

and condensate field.[230] However, according to SOCAR leadership, the Azerbaijani government will peruse other fields in the offshore Caspian, such as "Absheron", "Umid" and the deep-lying gas in the "Azeri-Chirag-Guneshli" (ACG) block and export any produced gas to the EU markets through TANAP, in addition to any possible volumes from the Central Asian countries.[231] ACG alone has 500 BCM worth deep-lying gas reserves,[232] which is almost equal to the aggregate annual consumption of the EU. In total, Azeri gas export potential is expected to stand at around 40-50 BCM in the middle of the next decade and the country's leadership expects most of it to go to the EU market.[233]

4.1. Advantages of TANAP

Due to its natural monopoly character,[234] pipeline gas transportation have different implications for the suppliers and the consumers, especially if third - transit countries are involved in the process. Taking these aspects of pipeline transportation into account, TANAP offers several advantages and disadvantages for the suppliers and the consumers alike.

Supplier's perspective - TANAP is based on a dedicated pipeline concept, which is physically separate from the Turkish national grid and thus, will operate independent of the Turkish government's economic and political control. TANAP HGA grants TANAP Project Entity the exclusive right to conduct the transit passage of natural gas via the Trans-Anatolian Pipeline.[235] In this vein, since SOCAR owns the majority of stakes in the TANAP project entity, TANAP will allow Azerbaijan to exercise control over the transportation of its gas up to the EU border and keep the interference of the principal transit state, *i.e*. Turkey, to the minimum. Without TANAP if Turkey reduces the transit of gas to the EU only to serve its domestic consumers during the harsh climatic conditions,[236] this would undermine the reliability of SGC as such. Therefore, especially in the absence of Europeanisation of Turkish gas market (which I will analyse in the following chapter) the independence of TANAP from Turkish political establishment is a vital contribution to the

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230 Shah-Deniz II is expected to produce 16 BCM of additional gas, 6 of which is slated for Turkish market, while the remaining to be exported further into the EU.

231 Emil Ismayilov, 'SOCAR: TANAP to Allow Transporting Gas from Caspian Littoral Countries to Europe', *Trend*, 16 November 2012 <http://en.trend.az/capital/energy/2088905.html> [accessed 19 November 2012].

232 Ismayilov, 'SOCAR: TANAP to Allow Transporting Gas from Caspian Littoral Countries to Europe'.

233 Interview with a senior official from SOCAR, 29/06/2015, Brussels.

234 Whoever controls the pipeline, can in principle control the access of the third parties to the pipeline, thus affecting the competitiveness of gas supply.

235 Parviz Babayev, 'TANAP: General Project Status' (presented at the stakeholder consultation of the Southern Gas Corridor Regional Group meeting of the Projects of Common Interest, European Commission, 2015).

236 See e.g. 'Turkey Sends Gas to Greece as EU Slams Gov't in Athens', *Hurriyet Daily News*, 20 February 2012 <http://www.hurriyetdailynews.com/turkey-sends-gas-to-greece-as-eu-slams-govt-in-athens.aspx?pageID=238&nid=14137> [accessed 15 August 2013].

reliability of the SGC, as notwithstanding any assurances by the Turkish establishment, the authorities in Baku would always be weary of the safe transit of gas from Georgian border to the EU without Baku's control of transit across Turkey.

Hence, both the *dedicated-pipeline* character, as well as the majority stakes owned by SOCAR represent the biggest advantages of TANAP for the Azeri government (the principle supplier of gas). Along with security in transportation, such a commercial structure will allow the Shah-Deniz consortium and SOCAR to streamline the development of the mega-project along the entire value chain and coordinate different segments into one single project.

Last but not least, since TANAP stops at the EU-Turkey border, it will allow Azeri government to diversify its gas export portfolio to multiple markets within the EU - Central, Southern and South-Eastern European markets and ensure security of demand through multiple consumer base.

Consumers' perspective - TANAP also offers several advantages from the viewpoint of the EU gas supplies. It was no secret that Turkish government had tried to link the construction of Nabucco classic to the progress in Turkey's EU membership bid.[237] Such a strategy on the part of the Turkish government could potentially undermine the credibility of the entire Southern Gas Corridor and question the security of gas supply across the Turkish territory. However, since TANAP will be constructed and operated with the majority stakes under SOCAR's ownership, this will give the EU a comparative advantage vis-á-vis Turkey should the latter decide to once again resort to *soft blackmailing* strategy. Thus, if the EU consumers start buying gas directly from Azerbaijan, instead of Turkish re-exports, it will shelter them from Turkish gas cut-offs for whatever reason it might be for.

4.2. Disadvantages of TANAP

Supplier's perspective - The commercial viability of gas transportation via pipelines, *inter alia*, depends on the technical capacity of the pipeline and the volumes transported. The bigger the volumes, the less will be the fixed costs of transportation per unit of gas, for the costs will be shared over a larger volume of gas that is being transported. In this vein, although TANAP will give the Azeri government (the principle supplier) more control over the midstream transportation (unlike Nabucco classic), it nevertheless had not solved the problem of lack of gas supplies. Shah-Deniz consortium is still determined to export no

[237] 'Turkey Blackmailing EU Over Gas Pipeline, German Minister Says', *Deutsche Welle*, 2009 <http://www.dw.de/turkey-blackmailing-eu-over-gas-pipeline-german-minister-says/a-3962409> [accessed 1 August 2013].

more than 10 bcm gas to the EU markets during the first phase of the opening of the Southern Gas Corridor. 10 bcm alone, on the other hand, would not make gas throughput via TANAP economically competitive in the downstream markets due to higher transportation tariffs per unit of gas (or TANAP could incur sunk costs).

This problem was partially remedied by the agreement to transport Turkey's share of gas from the Shah-Deniz II - i.e. 6 bcm - via TANAP to Eskishehir and Istanbul in Turkey, hence increasing the total throughput from 10 to 16 bcm (6 bcm slated for Turkey and 10 bcm for the EU).[238] Such an arrangement will spread the cost of transportation across the 16 bcm, although only 10 bcm of it will continue into the European markets during the initial phase.

However, the gas sales deals with the consumers to be supplied via TANAP envisage larger spot-pricing mechanism (80 to 100%),[239] which is more volatile than oil-indexation. Therefore, Azerbaijani suppliers will have to increase gas transit volumes through TANAP in the future, in order to reduce the *transportation costs* component of the gas prices offered to the final consumers and make the sales of Azeri gas in the EU markets competitive.

Consumers' perspective - Despite its enthusiastic acclaim by the EU (and the USA), TANAP does not offer the kind of competitive pipeline access as the now deceased Nabucco classic. Unlike Nabucco, which guaranteed 50% of the pipeline capacity to third party shippers, TANAP does not envisage such a liberal pipeline and by extension, market access mechanism.[240] As Azeri SOCAR will retain 58% stakes in TANAP in the longer term, it will likely to exercise *a right of first call* on the pipeline's capacity. This may, theoretically, result in SOCAR prioritising Azeri gas, while impeding other potential suppliers' access (e.g. gas from Turkmen, Iraq and Iran) to TANAP and the markets that it will subsequently supply. The absence of the guaranteed third party access to transportation capacity across Turkey, on the other hand, will likely to create significant transit risks for the prospective trans-Caspian gas flows from Turkmenistan to the EU and undermine its realisation.[241]

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238 Interview with a senior official from SOCAR, 29/06/2015, Brussels. This was also indicated during the TANAP presentation during the Southern Gas Corridor Regional Group meeting as part of the EU projects of common interest (PCI) stakeholder consultation, February 24, 2015, Brussels.

239 Oleg Vukmanovic and Stephen Jewkes, 'Italian Gas Deals with Azerbaijan to Break Systemic Oil-Link', *Reuters*, 29 April 2014 <http://www.reuters.com/article/2014/04/29/italy-gas-azerbaijan-idUSL6N0N942A20140429> [accessed 3 May 2014].

240 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

241 The necessity of eliminating transit risks across Turkey was also highlighted by the EU report on the Trans-Caspian Pipeline project in order to make the latter commercially and politically feasible. *Caspian Development Corporation - Final Implementation Report*, 2010

Nonetheless, taking into account Azerbaijan's long-term strategy to become a strategic transit corridor for Central Asian gas exports, it can be expected that SOCAR will gradually encourage third party access to the major transportation lines under its control, especially once the gas output in Azerbaijani fields start to decline. However, given the massive gas export contracts already in place between Turkmenistan and China, concerns rise about whether the window of opportunity for tapping Central Asian gas is closing too fast. This is especially a worrying trend given the fact that global demand for natural gas is shifting towards emerging Asian economies.

Moreover, guaranteed access to the major transport conduits like TANAP could incentivise the resolution of constitutional disputes between Iraq and the Kurdistan Regional government over the share of energy revenues and facilitate Iraqi gas exports to the EU. Cognisant the fact that additional gas flows through TANAP can reduce the cost of transport for Azeri gas too, SOCAR must, in principle, be interested in facilitating third party access to TANAP. This will dependent on the business model of the operation of TANAP and the profits that third party gas can generate for the owners of TANAP in the case of the availability of the free capacity in the pipeline.[242] However, this can only be realistically expected to materialise only in the long-term perspective, as gas production in Iraq and Iran for that matter is less costly, thus more competitive vis-à-vis current Azerbaijani gas.

5. TAP as the final home stretch

With TANAP replacing the Turkish section of the Nabucco *classic* pipeline, the competition for the final leg of the Southern Gas Corridor continued between Trans-Adriatic Pipeline (TAP) and Nabucco West (NW) until the former came on top of the pipeline race on June 28, 2013, when the Shah-Deniz consortium declared TAP[243] as its preferred route for the delivery of Azeri gas to the EU.[244] This followed by Shah-Deniz consortium announcing its final investment decision (FID) into the field on December 17, 2013, that is to produce gas slated for the EU market.

<https://ec.europa.eu/energy/sites/ener/files/documents/2010_12_report_cdc_final_implementation.pdf> [accessed 5 February 2015].

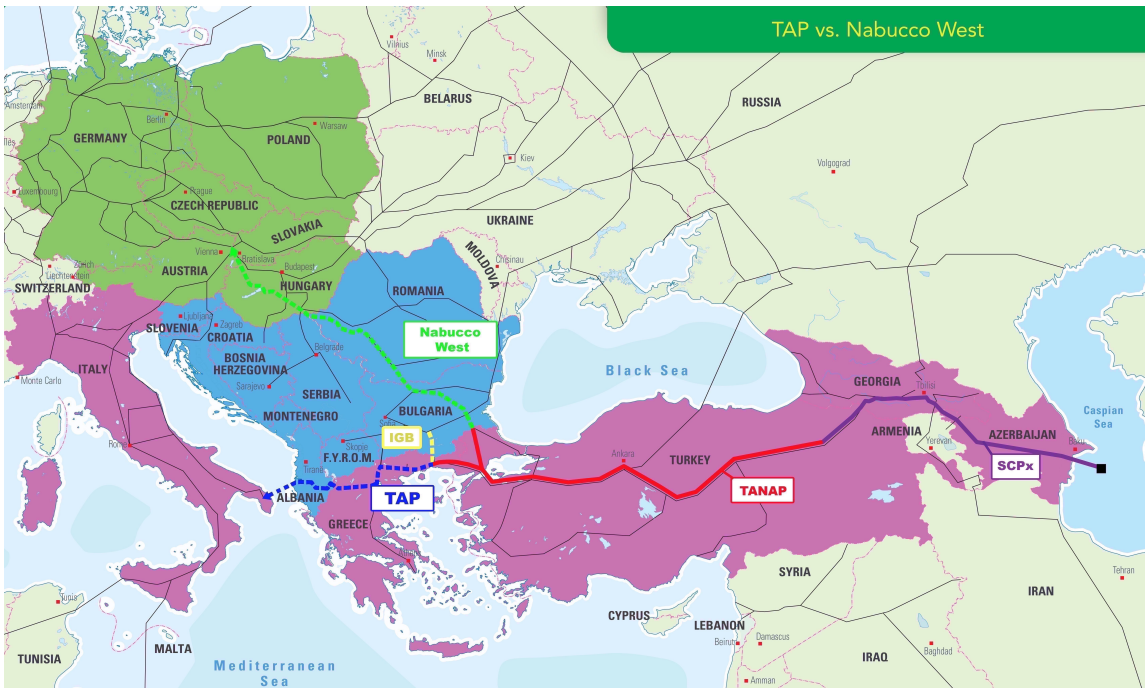
[242] Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels. Similar view was also voiced by the EC/DG Energy official during the relevant interview, 03/May/2013, Brussels.

[243] TAP's shareholding is comprised of BP (20%), SOCAR (20%), Statoil (20%), Fluxys (19%), Enagas (16%) and Axpo (5%). The pipeline will have 10 bcm/a initial capacity, but can be expanded further by additional 10 bcm/a up to total 20 bcm/a.

[244] 'Press Release: Shah Deniz Targets Italian and Southeastern European Gas Markets through Trans Adriatic Pipeline' (BP, 28 June 2013).

With the route length of 867 km and traversing the territories of Greece, Albania and Italy, TAP will supply combined 10 bcm gas to Bulgarian,[245] Greek and Italian markets starting from 2020. In contrast, Nabucco West would follow the original Nabucco classic route within the EU, but only starting from the EU-Turkey border (see, **Fig. 6**).

Fig. 6: Trans-Adriatic and Nabucco West pipelines | Prepared by the author using publically available information.



Although a late-comer to the pipeline race, TAP's *victory* over Nabucco West was conditioned by several fundamental factors:

- *Commercial viability* - Since the entire SGC envisioned investment worth over $45 bln, gas prices in the final supply markets was a key economic indicator to ensure that the entire project is commercially viable and avoid sunk costs. Higher gas prices in Greece and Italy, thus, ensured that TAP comes on top of the pipeline race. In contrast, the national and regional markets to be supplied by Nabucco West would incur negative netback for the Shah-Deniz consortium, hence, undermining the economic rationale of pursuing the entire alternative energy corridor idea.[246]

[245] Strictly speaking, gas to Bulgaria will be supplied via Interconnect Greece Bulgaria (IGB) and not Trans-Adriatic Pipeline (TAP).

[246] Interview with a senior official from SOCAR, 29/05/2015, Brussels.

In general, the economics of pipeline transportation is seriously affected by the distance between the supply and demand points and the transportation costs per unit of distance, which includes both OPEX and CAPEX. The shorter the route to the final market, the lower will be the *transportation costs* element in the final price offered to the end consumers. In this regard, due to 459 km shorter transportation route compared to Nabucco West, TAP offered cheaper transit tariffs $3.85 (50 cents cheaper than NW) per thousand cubic metre/ 100 km of the pipeline length.[247] In real terms, this would mean that every thousand cubic metre gas sold in Baumgarten via Nabucco West had to be at least $19.96 more expensive than the same volume sold in Italy via TAP. In the presence of alternative gas supplies (even if limited), not all the costs can be transferred onto the final consumers and will have to be compensated at the expense of the producer netback. Thus, in the backdrop of lower CAPEX of TAP vis-a-vis NB (€4.4 vs. €6.6 bln) the decision of the Shah-Deniz consortium was as commercial as it gets.

- *Strategic substance* - Either pipeline offered shareholder stakes for Shah-Deniz consortium members, including Azeri SOCAR, which was one of the key conditions of the country that owns the gas.[248] Furthermore, SOCAR acquired 66% of the Greek gas distribution company DESFA in 2013, which will see Azeri national champion enter the EU midstream for the first time. Although there are no direct links between the selection of TAP and the acquisition of DESFA, the move promises a strategic synergy for tapping into the regional markets and will allow SOCAR to continue its business in the mid- and downstream segments of gas supply chain when Azeri gas production starts declining in the future.
- *Demand for gas* - In terms of supply volumes, Nabucco West expected to sell around 4-5 bcm/a along the route to Bulgaria, Romania and Hungary. The remaining 5-6 bcm/a was expected to be transported to Baumgarten in Austria.[249] In addition to its primary markets, Bulgaria, Greece and Italy, TAP offers prospects of gas supply to the Western Balkan countries - Albania, Montenegro, FYROM, Croatia and Bosnia–Herzegovina, which currently have small or no gas markets. Individually, these countries may present small individual demand, but in combination these markets can offer aggregated demand, which will be quite important for ensuring security of demand for the Shah-Deniz producers.

[247] Shahin Abbasov, 'Azerbaijan: When It Comes to Pipelines, It's Not Personal, It's Strictly Business', *EurasiaNet*, 19 July 2013 <http://www.eurasianet.org/node/67277> [accessed 10 May 2014].
[248] Roberts, 'The Southern Corridor: Baku-Tbilisi-Ceyhan's Gas Legacy', p. 84.
[249] Rzayeva and Tsakiris, *Strategic Imperative: Azerbaijani Gas Strategy and the EU's Southern Corridor*, p. 28.

That said, however, from the point of the European Union, the contest was not between Nabucco West or TAP, for either pipeline would bring qualitatively new gas to the EU market. Therefore, for the EU it was not an *"either - or"*, but rather *"which one comes first"* contest.[250] At the time, the European Commissioner for Energy Günther Oettinger, who witnessed the decision-making on the SGC through to the end, noted that, *"What we see today is just the beginning. A decision to have TAP built first and to bring more gas later means that the route to Austria – currently Nabucco West – is still on the table. The question is not either one or the other, in the medium term both are needed. This is certain: we will need more gas in 2020, and Caspian gas is a good response to this need."*[251]

With the FID in Shah-Deniz II and the selection of TAP as the main (if only the first) pipeline to deliver 10 bcm/a Azeri gas to the EU markets from 2020, Southern Gas Corridor has reached its implementation phase. Obviously, 10 bcm/a does not stand out vis-à-vis Russian supply volumes to the EU, which stood at 155 bcm in 2013 and made up 30% of the EU consumption. In aggregated terms, it constitutes only 2% of the total EU demand.

Nonetheless, this argument overlooks the regional dimension and contribution of the SGC. The first volumes from Azerbaijan are not expected to be dispersed across the entire EU market and will be supplied to only a small number of national markets. Therefore, the contribution of 10 bcm of Azeri gas to lessening the dependence on Russian supplies in vulnerable countries is expected to be much higher. This can be revealed by statistically analysing the contribution of Shah-Deniz II gas to the reduction of supply dependence on Russian (*supply source concentration*) in Bulgaria, Greece and Italy - the primary supply markets of TAP. This is captured by the supply vulnerability index of Greece, Bulgaria and Italy with or without the initial SGC volumes. The index demonstrates the geographical concentration of domestic energy consumption in these countries and is calculated by dividing the imports share of the single biggest supplier (in our case Russia) by the overall imports and converting the outcome into percentage value[252] (see **Fig. 7**).

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250 Vladimir Socor, 'Old and New Options Considered in the Post-Nabucco Era', *Eurasia Daily Monitor*, 28 June 2013 <http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=41090&tx_ttnews%5BbackPid%5D=27&cHash=f249db3f8e6c17c9b39df2d6f65e8113> [accessed 30 June 2013].

251 Günther H. Oettinger, 'Shah Deniz Decision: More Gas for Europe', *Natural Gas Europe*, 1 July 2013 <http://www.naturalgaseurope.com/shah-deniz-decision-oettinger> [accessed 2 July 2013].

252 Chloé Le Coq and Elena Paltseva, *Common Energy Policy in the EU: The Moral Hazard of the Security of External Supply* (Stockholm: Swedish Institute for European Policy Studies (SIEPS), 2008), p. 29 <http://www.sieps.se/sites/default/files/67-20082.pdf> [accessed 3 June 2014]; García-Verdugo and Muñoz, 'Energy Dependence, Vulnerability and the Geopolitical Context', p. 41.

Fig. 7: Supply vulnerability index

$$\textbf{\textit{Supply vulnerabilty}} = \frac{single\ source}{total\ imports} \times 100\%$$

To that end, 2 different scenarios can be used as a basis for comparative analysis: (See **Table 3**).

- **Scenario 1**: SD II volumes meet the equivalent amount of additional imports over 2011 levels (Russian supplies at 2011 level/2011 total imports + SD gas),
- **Scenario 2**: SD II volumes replace the equivalent amount of Russian supplies with imports at 2011 levels (Russian supplies at 2011 level – SD gas/2011 total imports),

The table indicates that, the gas supply situation varies across the Southern and South-Eastern European markets. While Italy has a well-diversified supply portfolio, Bulgaria is 100% reliant on Russia for its total imports and the same figure for Greece stands at 59.87%.

According to existing gas sales agreements, Italy will receive 8 bcm/a, while Bulgaria and Greece each will receive 1 bcm/a from the second phase of the development of the Shah-Deniz field. Although modest vis-à-vis Russian exports, the new gas supplies from Azerbaijan can reduce Bulgaria's dependence on Russian gas from 100% by up to 35.41% depending on 2 different scenarios demonstrated in Table 1. In *scenario 1* contracted Shah-Deniz volumes meet the equivalent amount of additional imports in 2020 over 2011 levels - 1 bcm/a, while reducing the share of Russian supplies in Bulgarian total imports from 100% down to 73.85%. While *scenario 1* presumes (1 bcm/a) increase in total imports, *scenario 2* envisages the imports in 2020 to stay at 2011 levels, thus, leading Shah-Deniz gas to replace 1 bcm of Russian supplies per annum and subsequently decreasing the dependence on Russia from 100% down to 64.59%. The current Russia-Bulgaria gas sales & purchase contract envisions 2.9 bcm/a gas supplies to Bulgaria until 2022.[253] Considering that Shah-Deniz supplies will reach Bulgaria around 2019-2020, it will give Bulgarian government comfortable time to readjust its next gas purchase contract with Russia in line with domestic demand and alternative supply options.

[253] 'Russia, Bulgaria Sign Gas Supply Deal for Next Decade', *RIA Novosti*, 15 November 2012 <http://en.ria.ru/business/20121115/177493177.html> [accessed 11 May 2014].

Table 3 - South East Europe natural gas supply vulnerability and the SGC | The figures are compiled and calculated by the author using IEA and EU sources.[254]

		Gas statistics for 2011 in mln m3/a (IEA)					Reduction of supply vulnerability vis-à-vis Russia in 2019/2020		
		Total consumption	Domestic production	Total Imports	Imports from Russia	Current ***supply vulnerability index*** vis-à-vis Russia	SH II contractual supplies for 2019-2020 (mln m3/a)	Scenario I	Scenario II
Nabucco West	Romania	14,394	10,964	3,145	3,045	96.82%	-	-	-
	Hungary	11,557	2,766	8,019	5,218	65.07%	-	-	-
	Austria	9,475	1,776	14,631	6,221	42.52%	-	-	-
TAP	Bulgaria	3,300	476	2,824	2,824	100.00%	1,000	73.85%	64.59%
	Greece	4,737	6	4,510	2,700	59.87%	1,000	49.00%	37.69%
	Italy	77,919	8,449	70,369	19,634	27.90%	8,000	25.05%	16.53%

Similarly, with new volumes from SH II, Greece and Italy can reduce their dependence on Russian gas by up to 22.17% and 11.37% respectively depending on the 2 scenarios as demonstrated in Table 3. Thus, although the initial supplies through SGC will amount to an insignificant 2% of the overall EU demand, the contribution of these (10 bcm/a) volumes will be far more significant at the level of individual member states that have contracted it. Reduction of dependence on Russian supplies, on the other hand, will reduce their relative vulnerability against supply shocks from a single dominant source. The bigger the current supply vulnerability, the more substantial will be the contribution from the SGC.

Nonetheless, the question still remains open regarding the access of other Nabucco hopefuls to the alternative energy sources. As Table 3 indicates, although Russia sells more gas to Italy, Greece and Bulgaria combined, Romania, Hungary and Austria are at least just as dependent on a single source as the South European countries - the question TANAP/TAP design of the SGC did not address. Nonetheless, as the next section will indicate, the prospect of additional Caspian gas reaching Central European markets is not as dim as it may initially seem due to the new market design envisaged by the EU GTM.

[254] *Natural Gas Information 2013* (Paris: IEA, International Energy Agency, 2013); 'EU Energy Trends to 2030: Update 2009' (European Commission, DG Energy, 2010).

6. EU Natural Gas Target Model and Southern Gas Corridor

In broad terms, EU internal gas market strategy envisages two mutually inclusive strands of policy at:

1. ***"Software level"*** - establishment of the rules of market, and,
2. ***"Hardware level"*** - establishment of physical infrastructure to enable the functioning of the market rules.

The first strand ushers in the establishment of a new Gas Target Model (GTM),[255] which is envisioned by the Third Energy Package and currently being codified in the European Network Codes for gas.

As per the legal prescriptions of the EU Third Energy Package, the GTM envisages the establishment of Entry-Exit (E/E) zones, with individual virtual trading points (VTP, also called hubs), where entry capacity into the system is booked separately from the exit capacity from the system.[256] Whether created (a) along the national borders of a single member state, (b) several E/E systems within one member state or (c) one E/E encompassing several member states,[257] an E/E system eliminates the notion of contractual paths in natural gas transportation in a traditional point-to-point sense. In this regard, once gas enters an E/E system through any of the entry points, it should be deliverable to any exit point from the system,[258] whether to the end consumers or to the adjacent systems.

Establishment of the GTM diminishes (if not eliminates) the dependence of gas delivery from specialised transit pipelines across national (E/E) systems. Such a scenario is underpinned by two factors: (1) since the EU energy legislation eliminated differential treatment of transit gas from the gas earmarked for domestic consumption, and, (2) so long as the price of gas is higher in the adjacent E/E zones than the gas price in the initial E/E zone (both registered at their respective VTPs) plus the cost of capacity at the interconnection points in between the relevant E/E zones, gas will always flow across the borders supported by the price signals.

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[255] CEER, *CEER Vision for a European Gas Target Model - Conclusions Paper* (CEER, 2011).

[256] This model is predicted by the EU Regulation 715/2009 on conditions for access to the natural gas transmission networks.

[257] It is expected that, initially the E/E systems will correspond to the national borders of individual member states, then expand beyond depending on the market liquidity. See e.g. Yafimava, *The EU Third Package for Gas and the Gas Target Model*.

[258] See e.g. *Study on Entry-Exit Regimes in Gas* (Prepared by DNV KEMA; Commissioned by the EC, 2013) <http://ec.europa.eu/energy/gas_electricity/studies/doc/gas/201307-entry-exit-regimes-in-gas-partb.pdf> [accessed 22 November 2014].

Obviously, such a market design (*software*) necessitates the existence of necessary *hardware* - physical interconnection points (IPs) between the E/E systems in order to enable the physical flow of gas. The EU policies in this sphere are attuned towards market integration: a) through the construction of the necessary interconnections among the member states, and b) ensuring the flexibility of existing interconnection points through the availability of reverse flow capacities. Although moderate in terms of throughput capacity, but much denser in the area of coverage, these networks connecting the E/E systems are to lift the isolated member states from energy vulnerability and ensure that gas can be supplied to the member states far afield the initial EU entry points.

In order to foster this goal, envisaged by the EU Directive/73/2009 and Regulation/715/2009, national TSOs and ENTSO-G are required to prepare national and regional Ten Year Network Development Plans (TYNDP) every year and every two years respectively. Among these projects, a special list of *projects of common interest (PCIs)* is prepared by the EC every two years, which will have signification contribution to the Unions energy policy objectives, namely the security of energy supply, sustainability and competition.

In October 2013, supported by the TEN-E guidelines,[259] the European Commission published the first list of 248 projects of common interest (PCIs). While eligible for Union funding under the Connecting Europe Facility (€5.85 bln between 2014-20), these projects are to foster market integration and address the issue of *energy islands*. In addition to the potential EU funding, the PCIs are to benefit from one-stop-shop permit granting procedure and shorter periods of project authorisation (3.5 years + 9 months).

Furthermore, underpinned by the new competences under the Lisbon treaty,[260] the EU has taken other legislative measures in order to ensure security of gas supply to the Union. The adopted EU Regulation 994/2010 requires member states to ensure that "*in the event of a disruption of the single largest gas infrastructure, the capacity of the remaining infrastructure, determined according to the N – 1 formula […] is able […] to satisfy total gas demand of the calculated area during a day of exceptionally high gas demand occurring with a statistical probability of once in 20 years*" by December 3, 2014. This is to be ensured in

[259] 'Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on Guidelines for Trans-European Energy Infrastructure and Repealing Decision No 1364/2006/EC and Amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009', 2013.

[260] 'Treaty of Lisbon: Amending the Treaty on European Union and the Treaty Establishing the European Community', Article 176 A.

addition to enabling "*permanent bi-directional capacity on all cross-border interconnections between Member States*" by 3 December 2013 at the latest.[261]

With the timely establishment of the necessary *hardware* and full implementation of the relevant *software,* gas sourced via the Southern Gas Corridor can eventually reach beyond the markets to be initially supplied via TANAP/TAP/IGB pipelines, in particular in Central and Southeast Europe.[262] Under the current architecture of the Southern Gas Corridor, Italy is well positioned to serve as a gateway into the Central European gas markets. In line with the EU rules, Snam Rete Gas, the Italian TSO and operator of the PSV (Italian virtual trading point, i.e. hub) is currently in the process of implementing the *"Support to the North West market and bidirectional cross-border flows"*, a significant infrastructure development project included into its TYNDP 2014-2023. The project envisages the expansion of the Northern Italian transmission capacity, along with the exports points at the Swiss and Austrian borders. With the FID already agreed in two phases, Italian export capacity to Switzerland at *Passo Gries* and to Austria (the gas hub of Central Europe) at *Tarvisio* will be 22 mln m^3/d and 18 mln m^3/d respectively by 2018.[263] These translate into 8 and 6.5 bcm annual export capacity to Switzerland and Austria (and *beyond*) and can serve as vital interconnection points in case Central European countries see sudden drop in Russian gas supplies or would like to further reduce their dependence thereof.[264] Since EU GTM eliminates the necessity of specialised transit pipelines, any additional Caspian gas to be supplied to the Italian E/E system through an entry point in Southern Italy can be, in principle, delivered to the exit point(s) in the North via the domestic transmission lines (which are in the process of expansion under the TYNDP). This, on the other hand, will allow for future additional Caspian gas to be re-exported from Italy to Central European markets via the interconnection points at the Swiss and/or Austrian borders on temporary or permanent bases, thus improving security of supply in the Central and Eastern European countries.

It is also important to note that, TAP's regulatory regime encourages the expansion of the pipeline and is amicable to the potential third-party suppliers. The pipeline has received a third-party access (TPA) exemption from the EU only for the initial 10 bcm capacity, while

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261 'Regulation (EU) No 994/2010 of the European Parliament and of the Council of 20 October 2010 Concerning Measures to Safeguard Security of Gas Supply and Repealing Council Directive 2004/67/EC', 2010, Article 6.

262 'EC, EU Commission Welcomes Decision on Gas Pipeline: Door Opener for Direct Link to Caspian Sea, Press Release - IP/13/623', 2013; 'Press Release: Shah Deniz Targets Italian and Southeastern European Gas Markets through Trans Adriatic Pipeline'.

263 'Ten-Year Development Plan of the Natural Gas Transmission Network 2014-2023' (Snam Rete Gas, 2014), p. 56.

264 Snam is expecting to create similar export capacity to Slovenia as well. See 'Ten-Year Development Plan of the Natural Gas Transmission Network 2014-2023', p. 58.

the expansion capacity (additional 10 bcm) must still be offered to other market participants on an equal basis. Exemption decision obliges TAP to perform market tests in order to determine interest for the expansion capacity when it starts its commercial operation and every subsequent two years and build the requested capacity if there is sufficient market demand.[265] This requirement is not only legally binding, but is also incentivised by TAP's business model and the tariff regime.

To start with, TAP's entire expansion capacity (*i.e.* additional 10 bcm/a) will incur only the 18% of the CAPEX of the initial 10 bcm/a capacity.[266] Furthermore, TAP's tariff methodology is approved as such that, any additional capacity built on top of the initial 10 bcm/a will lower tariffs, both for the initial and the expansion capacity *uniformly*. Thus, since the expansion capacity will be much cheaper to build, it will also *lower the depreciation per unit of capacity*, resulting in lower uniform tariffs (by up to 40%) for, both initial capacity holders, as well as new parties.[267] In this vein, the regulatory regime of TAP will only encourage the access of new (non-SH II) suppliers to the pipeline, which can then be re-exported to the Central and Western European markets across the Italian E/E system.

Secondly, additional Caspian gas can be supplied to Romania, Hungary and beyond following the establishment of the relevant E/E systems in Bulgaria and Romania and the interconnection thereof, without the need of constructing of a stand-alone transit pipeline (like Nabucco West) across Bulgaria and Romania. This is underpinned by the logic of the E/E system, which eliminates traditional point-to-point gas transportation regime. Once E/E market areas are established and interconnected, independent shippers (suppliers) will be able to buy gas in Greek/Bulgarian/etc. hubs (once they are established) and channel them to Romania, Hungary and other adjacent markets. In doing so, they will be required only to book entry and exit capacities at the relevant IPs without the need to engage in a point-to-point transportation contract with a stand-along transit pipeline. It is also worth noting that, the EU GTM calls for gas to be delivered from at least 3 different sources for the establishment of liquid trading hubs.[268] Thus, the realisation of the SGC will

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[265] 'Final Joint Opinion of the Energy Regulators on TAP AG's Exemption Application' (National Regulatory Authorities of Italy, Albania and Greece, 2013).

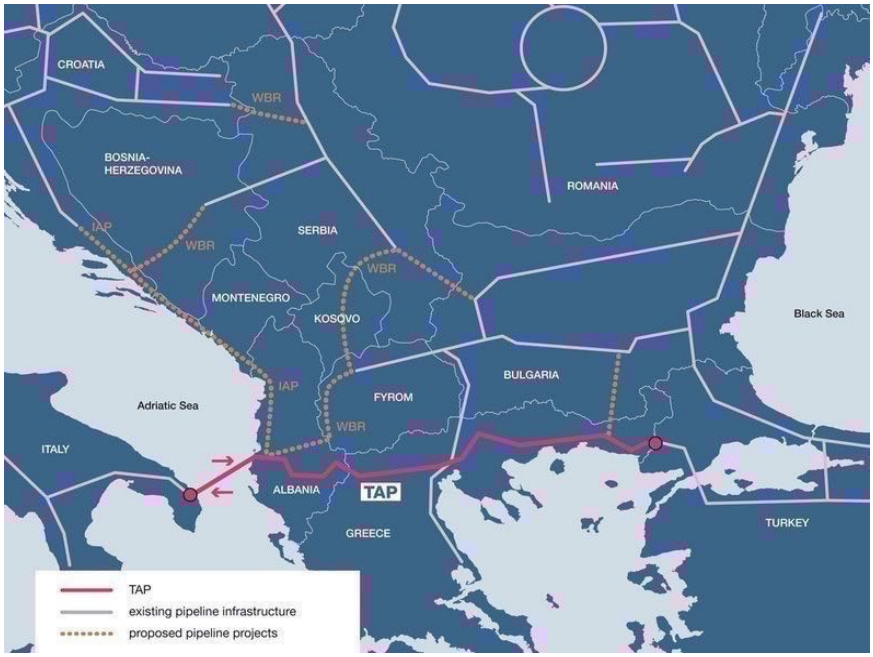
[266] 2013 EC (2013), 'Commission Decision on the Exemption of the Trans Adriatic Pipeline from the Requirements on Third Party Access, Tariff Regulation and Ownership Unbundling Laid down in Articles 9, 32, 41(6), 41(8) and 41(10) of Directive 2009/73/EC, C(2013) 2949' (European Commission, 2013), p. 5.

[267] EC (2013), 'Commission Decision on the Exemption of the Trans Adriatic Pipeline from the Requirements on Third Party Access, Tariff Regulation and Ownership Unbundling Laid down in Articles 9, 32, 41(6), 41(8) and 41(10) of Directive 2009/73/EC, C(2013) 2949', p. 31.

[268] CEER, *CEER Vision for a European Gas Target Model - Conclusions Paper*.

not only bring new alternative gas into the market, but will also facilitate the establishment of liquid trading hubs in South Eastern Europe.

Fig. 8: TAP and the supply potential to South-East Europe | TAP webpage, 2015.



Last but not least, in addition to the originally envisaged markets in Central, Eastern and Southern EU markets, the selection of TAP presents a prospective security of supply benefits to the countries of the Western Balkans. Currently, Serbia relies on Russian gas for 88% of its domestic demand, FYR Macedonia 100%, Bosnia and Herzegovina 100% and EU member state Croatia 39%, while Albania, Montenegro and Kosovo lack domestic gas grids and are entirely reliant on fuel oil and dirty coal for their primary energy consumption. With this in mind, prospective cooperation between TAP and the Ionic-Adriatic Pipeline (IAP) (see **Fig. 8**), running from Albania to Croatia, will allow Caspian and potentially Middle Eastern gas to reach the isolated Balkan markets, or create new ones.

It is also important to note that, EU energy space is a moving target. It changes and evolves almost every year and month affected by the multiplicity of factors that cannot be envisaged in advance. On the one hand, during the accomplishement of this thesis the prices for oil ranged from 90$ to 140$ and then down to as low as 25$ per barrel. This affected the economic feasibility of thousands of energy projects around the globe, including those that have been analysed as part of this chapter. The SGC is almost half way through its development with more than half of investment already in place. Nonetheless, the price of energy commodities, including coal, which directly competes against natural

gas in the market, will affect the functioning and indeed, the potential role that SGC will play for the EU energy security, too.

On the other hand, the relevance of the SGC in South Eastern Europe has increased following the cancellation of the South Stream pipeline by Russian President Vladimir Putin in December 2014.[269] This followed by Russian Gazprom together with its EU partners announcing a new pipeline in November 2015, dubbed Nord Stream 2 from Russian Baltic coast to Germany under the bed of the Baltic Sea. Similar to South Stream, the Nord Stream 2 is aimed at minimising Russia's dependence on Ukrainian transit route and double the capacity of the existing direct link between Russia and its biggest EU national gas market – Germany.[270]

If this project materialises, it will only increase the importance of the SGC. With Nord Stream 2 in place and the Ukraine transit route scrapped, the countries in South-Eastern Europe will have to receive their Russian natural gas supplies through the entry point in Germany. This will increase both the distance that Russian gas will have to travel to reach th SEE countries, as well as the cost of transportation, hence increasing the prices offered to the EU consumers in this region. Accordingly, this can make natural gas supplied via the SGC more competitive vis-à-vis Russian supplies, while economically justifying its expansion in the long term as illustrated above.

7. Trans-Caspian realities

It is also important to point out that potential gas supplies from the Caspian is not confined to Azerbaijani reserves only and might potentially include the available export capacity from Central Asia once the necessary infrastructure across the Caspian Sea is in place.

Construction of the Trans-Caspian Pipeline (TCP), which is to carry Turkmen (and potentially Kazakh and Uzbek gas) to Europe has long been touted about without tangible headway on the ground (see **Fig.2**). Four factors have so far undermined the realisation of the project:

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[269] Jack Farchy, 'Putin Loses Face with Cancellation of "pharaonic" South Stream', *Financial Times*, 2 December 2014 <http://www.ft.com/cms/s/0/ea6e69a8-7a43-11e4-8958-00144feabdc0.html#axzz445OjoXJR> [accessed 27 March 2016].

[270] 'Germany Seeks to Overcome Opposition to Nord Stream 2', *EurActiv.com*, 1 February 2016 <http://www.euractiv.com/section/energy/news/germany-seeks-to-overcome-opposition-to-nord-stream-2/> [accessed 27 March 2016].

I. *Unresolved status* of the delimitation of the Caspian sea borders among the littoral states. In this regard, the maritime borders between Azerbaijan and Turkmenistan are yet to be determined, which hinders cooperation between the two sides. Bilateral relations are further strained due to the disputed gas field - Kapaz/Sardar, which situates on the claimed by both sides sea border.

II. *Regional geopolitics* presents the major stumbling block on the way of the realisation of the energy projects in the Caspian basin. Russia and Iran, holders of the first and second biggest gas reserves in the world, have long opposed to the direct access of the Western energy companies to the Caspian oil & gas.[271] Since Azerbaijan plays a *pivot role*[272] in the access to the Central Asian resources, Russia and Iran have long mounted pressure on Azerbaijan and Turkmenistan in order to prevent the construction of any trans-Caspian link prior to the resolution of the status of the Caspian Sea and due to the *environmental concerns*.[273]

I. *Political-economic rationale* has also played a part in putting the project on the back burner. Both Turkmenistan and Azerbaijan are gas producer countries and as such will be competing for a share in the same gas markets should the TCP is realised. Furthermore, Turkmenistan is not interested in any gas exports to the EU in volumes less than 30 bcm - 3 times the volume that Azerbaijan is slated to export from the second stage of Shah-Deniz. In addition to the massive investment required for the physical upgrades to the entire technical architecture of the SGC, such export volumes will create additional competition for the limited share in the EU markets. Moreover, since Turkmenistan prefers selling its gas only at the border without getting involved into the infrastructure development process and pipeline politics,[274] this would mean that the *political and economic costs* of SGC pipelines (including the TCP) will have to be borne by Azerbaijan and other SHD stakeholders. This would not be cost-effective in the best of all possible worlds, let alone the current geopolitical predicament that the regional actors find themselves. I will analyse these issue from the regulatory point of view in Chapter VI of this thesis.

I. *Asian competition* currently presents additional challenge for the European energy players in Central Asia. Unlike the EU, Chinese delegations to Turkmenistan

[271] Shaffer, *Energy Politics*, p. 84.

[272] For a strategic analysis, see, e.g. Zbigniew Brzezinski, *The Grand Chessboard: American Primacy And Its Geostrategic Imperatives* (New York, NY: Basic Books, 1998).

[273] Rovshan Ibrahimov, *Nabucco Project: How Far Is It From Realisation?* (Baku: Center for Strategic Studies (SAM), 2010), pp. 68–69.

[274] Barysch, 'Should the Nabucco Pipeline Project Be Shelved?', p. 12.

usually arrive both with *an offer* and an *authority* to execute it on the spot.[275] This has allowed Chinese CNPC to conclude a 35 year-long "turnkey arrangement", under which the CNPC builds the necessary facilities, starts the production in onshore Turkmen fields, transports gas to China and then turns the operations over to Turkmengaz.[276] In overall, this contract envisages 60bcm/a gas exports to China in the next three and a half decades, which is likely to suck up much of the Turkmen production, thus, leaving little export capacity for the EU market.

In order to overcome these challenges, the EU is currently pursuing a *block gas purchasing strategy* - Caspian Development Corporation - from Turkmenistan, which will allow European companies to buy Turkmen gas in a single aggregated contract.[277] The CDC is to incorporate major EU energy companies who are interested in gas purchases from Turkmenistan, while not being able to offer sizeable gas demand individually. This is to meet three core conditions presented by the Turkmen government for its gas exports, namely, 1) sale of gas at the Turkmen border, 2) conclusion of gas sales & purchase agreement with a single big, as opposed to multiple small entities, and 3) ensuring long-term political framework under which short-term commercial adjustments can be operated.[278] If realised, underpinned by the Council mandate, the CDC is to push the European Commission beyond its competences under the EU Treaty. This will allow the legal and political aspects of the trans-Caspian energy corridor to be negotiated between the EU and the regional governments, while leaving the commercial details as regards the gas prices and volumes *"to Caspian and European companies to settle."*[279] Obviously, this will not turn the EU into a downstream gas purchaser, the role which will still have to be carried out by private and state energy entities. Nonetheless, the direct involvement of the EU, as a political actor, into the negotiations will bring the kind of *one-person-in-charge* certainty that so far has been offered only by the Russian and the Chinese energy champions.

With this in mind, however, the block gas purchasing mechanism creates additional new challenges. Firstly, aggregated demand mechanism may represent a breach of the EU's own competition rules. As gas will be purchased in a single contract under unified terms, the costs of gas supply will then be transferred onto the final consumers in the EU

[275] Richard G. Lugar, *Energy and Security from the Caspian to Europe* (Committee on Foreign Relations United States Senate, 12 December 2012), p. 26.

[276] Lugar, *Energy and Security from the Caspian to Europe*, p. 23.

[277] Nies, *Oil and Gas Delivery to Europe: An Overview of Existing and Planned Infrastructures*, p. 82.

[278] Michael Denison, 'The EU and Central Asia: Commercialising the Energy Relationship' (EUCAM, 2009), p. 10.

[279] David Buchan, *Expanding the European Dimension in Energy Policy: The Commission's Latest Initiatives* (Oxford: Oxford Institute for Energy Studies, 2011), p. 43.

markets, thus eliminating the incentive for the suppliers to engage into competition in the mid- and downstream markets. Therefore, the EU views the CDC as an ad hoc mechanism in order to overcome the relevant market difficulties in the Caspian basin and expects it to be dismantled once the relations start to mature.[280]

Secondly, since gas would be purchased in a *monopsony* fashion, it is likely to suppress competition in the upstream market to the detriment of other suppliers, namely Azerbaijan. Energy security for producers requires the availability of multiplicity of demand. Single aggregated demand, on the other hand, will change the balance of market power in favour of the single buyer (made of European companies), who can dictate the commercial terms of engagement, *inter alia*, gas prices and volumes. Thus, it can reasonably be expected that Azerbaijan will drag its feet, if not refuse outright to provide transit guarantees to the Turkmen gas purchased via CDC mechanism, as long as its own gas keeps on flowing.

Nevertheless, the prospects of channelling the Central Asian gas to the European markets may not be so dim in a long-term perspective. As it was indicated above, Azerbaijan aspires to position itself as a strategic energy corridor on the way to the EU. This allows one to reasonably predict that, once production fields in Azerbaijan start steaming off, official Baku will likely switch its role from an upstream actor into a midstream one. Then Azerbaijan might turn its *lukewarm* attitude towards the TCP into the project promoter. By buying Turkmen gas at the border in cheap and then reselling it onto the EU and world markets at dearer, Azerbaijan might effectively become a gas bridge between Europe and Asia.

8. Conclusion and implications

With the necessary agreements in place, the SGC has entered the final home stretch with modest but qualitatively new gas volumes slated for the EU markets in 2020 via the combination of SCPx, TANAP, TAP and IGB pipelines. Under the current supply & demand projections, these volumes will help to ease the dependence of Southern and South-Eastern European countries on Russian gas to a varying degree, while increasing their security of supply. The EU gas market design, on the other hand, has also transformed since the first inception of the idea of the SGC. Underpinned with dense interconnection capacity among the member states (E/E zones), the new EU gas market design is likely to eliminate the need to construct additional massive capacity stand-alone pipelines within

[280] Devlin and Heer, 'The Southern Corridor – Strategic Aspects for the EU', p. 6.

the EU borders. This accompanied a *subtle shift* in the EU priority of ensuring diversification of energy supplies. Previously, if the major emphasis was on the construction of the massive capacity pipelines *deep* into the EU markets, now the priorities have seemingly shifted in favour of *any pipeline* that brings qualitatively new volumes to the EU *borders*. The EU gas market design will then ensure that gas flows where it is needed most under commercial conditions.

Even the failure of physically linking other alternative suppliers (Turkmenistan, Iran and Iraq) at this stage can be addressed in the mid-to-long term (*in physical infrastructure terms*), as more and more gas will be needed in the European markets if only to compensate the dwindling indigenous production. With this in mind, the development of the SGC is to be viewed in two stages: 1) initiation of the Fourth Corridor by a dominant single supplier - Azerbaijan - which spearheads the construction of the necessary infrastructure and provides the initial volumes, and 2) expansion of the corridor and change of roles, where previously an upstream company SOCAR becomes a mid-and down-stream player and facilitates the access of other suppliers to the pipeline systems under its control. The latter scenario is in line with Azerbaijani general national energy strategy to become an important energy corridor for the Central Asian energy supplies towards the European markets.

For the European consumers, these two stages would ideally parallel, as opposed to follow each other. However, in the markets where new suppliers have to compete for a limited share under uncertain market and regional geopolitical conditions and where consumers cannot provide demand guarantees, merchants-led infrastructural projects are likely to fail to live up to expectations. Gas has to be sold and export routes determined before it can actually be produced, which therefore conditions the well-head-to-burner coordination of the owner of the gas. Thus, the shift in the balance of power in SGC from the EU merchants to the Caspian producers was a logical conclusion in the development of the decade-old mega project.

From this point of view, the current development of the Southern Gas Corridor can be argued to be of contribution to ensuring the EU energy security. However, the definition of the EU energy security that this PhD upholds, is *the diversity of energy supplies under competitive market conditions, which ensures its affordability and reliability.* In this vein, even though the establishment of the necessary infrastructure along the SGC is to contribute to the *diversity* of pre-existing energy supply to the EU, further measures are still required from an EU perspective to ensure that these new energy supplies are carried out under depoliticised, competitive market governance, which will in practice eliminate

the transit risks along the SGC. The concerns are related to the future gas supply to the EU, not only from Azerbaijan, but also from Iraq, Iran and Turkmenistan. The development of the necessary infrastructure must not automatically be equated to the establishment of the equitable market conditions for access to them, which generates further transit risks along the supply corridor.

Since Turkey, Georgia and Azerbaijan will constitute the main non-EU transit segment of the Southern Gas Corridor, elimination of transit risks across these countries requires a new dimension of policy actions that necessitates the establishment of the EU-sourced market rules along this energy supply corridor. The *regulatory* dimension of the SGC, which concentrates on the Europeanisation of the natural gas markets of the SGC countries, hence, will analyse the degree to which the EU has been successful in eliminating these transit risks to energy supply along this alternative energy corridor by exporting its domestic gas market rules into the SGC countries. With this in mind, the next chapter presents a detailed analysis of the regulatory dimension of the SGC and investigates the major avenues and the EU policy initiatives that are designed to underpin the expansion of the EU *acquis* to the SGC countries.

CHAPTER III: THE REGULATORY DIMENSION OF THE SGC

1. Introduction

The main aim of this chapter is to present a detailed analysis of the regulatory dimension of the SGC from the viewpoint of the EU external energy governance and investigate the major avenues and the EU policy initiatives that are designed to that end. In doing so, this chapter argues that, the *regulatory dimension* of the SGC is aimed at depoliticising the access to new gas sources and transit capacity along this very new energy corridor by promoting regulated market governance therein. It includes measures geared towards reducing non-market risks by shifting energy supply from bilateral political domain onto the multilateral market domain. If successful, this dimension will create institutional milieu through which the EU can pursue its energy interests in a preferred - depoliticised setting.

Having set this broader goal, this chapter analyses the specific elements in the EU energy legislation that is most relevant to eliminating transit and supply risks along the SGC (which manifests itself in the form of restriction of access to transit capacity for political and/or commercial reasons, as well as the lack of transparency in price formulation and/or excessive charges for transiting gas). These elements will serve as benchmarks for comparatively describing the success or the failure of the EU's external energy governance in Chapters IV, V and VI (in other words, whether the SGC countries and natural gas infrastructure projects are in compliance with the EU *acquis* or not).

To that end, I identify the rules on *unbundling*, *third party access* (TPA) and equal treatment of *transiting gas* as the major elements of the EU's energy *acquis*, which the Union is keen on extending along the SGC. Pertinent to pipeline transportation of natural gas, these specific rules target the elimination of economic and political hurdles to access to pipeline capacity. More specifically, the *unbundling* rules aim at eliminating (or substantially reducing) the power of the pipeline owners in influencing the day-to-day management of the pipelines; hence removing potential conflicts of (economic and political) interest in providing equal access to the transmission/transit networks. The TPA rules, secondly, aim at ensuring equitable and guaranteed (regulated) access of all interested parties to the pipeline capacity. Finally, "transiting" gas rules eliminate differential treatment of transit gas from the gas volumes destined for the domestic

markets; thus, transforming neighbouring national markets into a single cross-national market. Together, underpinned by the liberalisation of natural gas supply, these rules establish market conditions where gas volumes follow the price signals without being subject to non-market (political or economic) hurdles. In analysing these rules, I will indicate that, if successful, they will transform the SGC from a separate *corridor* leading to the single EU natural gas market to an integral part thereof.

Finally, this chapter presents and comprehensively analyses the major EU rule export avenues. In doing so, I devote special attention to the European Neighbourhood Policy (ENP) and its Eastern dimension - Eastern Partnership (EaP) as the youngest and the most comprehensive EU external energy governance tool, which has yet to be fully investigated by the existing academic literature. The purpose in doing so is to assess the internal dynamics of the EaP, which will have considerable influence on the outcome of the rule extension along the SGC.

2. SGC and ensuring market governance for gas in "transit"

In terms of spatial characteristics, non-market risks to natural gas supply in import-dependent countries can have both internal and external elements. While the former can be addressed to a certain extent through relevant domestic regulatory measures, the ability to tackle the latter usually remains beyond the legal sovereignty of the consuming countries concerned. These external risks usually appear during the *transit* of gas from the production sites to consumer markets via the transit countries and can be of commercial and political nature.[281] In the past, these transit risks happened between Russia and Belarus in 2004, as well as between Russia and Ukraine in 2006 and 2009[282]

The emergence of these transit risks related to Russian gas supplies in post-Cold War period were one of the primary drivers behind the urgency of establishing alternative gas supply corridors, especially the Southern Gas Corridor. Although the role of the SGC in addressing the supply risks incurred by high dependence on Russian gas has been widely investigated by the academic literature, the transit challenges related to the SGC itself were less so. Transit and market access risks *specific to gas industry* can be in the form of

[281] Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalisation*; *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 6.

[282] Checchi, Behrens and Egenhofer, *Long-Term Energy Security Risks for Europe: A Sector-Specific Approach*, p. 19; Katja Yafimava, *The Transit Dimension of EU Energy Security: Russian Gas Transit Across Ukraine, Belarus, and Moldova* (Oxford: Oxford Institute for Energy Studies, 2011).

restriction of access to transit capacity for political and/or commercial reasons, as well as the lack of transparency in price formulation and excessive charges for transiting gas.[283]

In the context of the SGC, these risks have emerged almost along the entire length of the alternative energy corridor at different times. The policy of Turkey was especially notorious in relation to its demands for high transit and domestic supply benefits. In the past, this has hindered the negotiations on Nabucco *classic* pipeline, as well as the transit of Azeri gas to the Western markets.[284] The state policies of another important actor along the SGC, Azerbaijan, have also presented the SGC with transit risks in the past 2 decades. In general, Azerbaijan can potentially serve not only as the gas source for the Southern Gas Corridor, but also as a transit corridor on the way to Central Asian reserves via a trans-Caspian linkage, which was specifically highlighted by the Prague Declaration on the SGC.[285] For this very reason ensuring favourable regulatory regime for natural gas in transit across Azerbaijan is just as important as sourcing gas from the country itself. For example, the blueprint for the Caspian Development Corporation (CDC), a mechanism proposed by the EC in order to explore joint - aggregated gas purchases from Turkmenistan (in order make the Trans-Caspian Pipeline (TCP) project commercially and politically viable), explicitly refers to *addressing transit issues* in Turkey, Georgia and *Azerbaijan* as one of the key risks to be resolved before moving Central Asian gas to Europe.[286] As such, transit risks to the transportation of Central Asian gas across Azerbaijan stem from the fact that Azerbaijan itself is a producer country. Thus, the urge of the country to prioritise its own gas exports can create a barrier for Turkmenistan in finding access to transit capacity in the SGC. In fact, the realisation of the Trans-Caspian Pipeline was put off in 1999 due to Azerbaijan's own gas discoveries and its aggressive play for the Turkish market.[287] Furthermore, even if Azerbaijan provides transit capacity

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283 In addition, transit risks can be associated with market failure to incentivise adequate investment in transportation/transit capacity, as well as security threats to transportation pipelines caused by wars, terrorism, as well as environmental calamities. Although these risks are very relevant to the SGC, too, I will concentrate on those risks, that are the result of sovereign intervention in natural gas in transit. Nonetheless, it is also pertinent to point out that, EU's regulatory approach to eliminating non-market risks is also relevant to dealing with market risks, i.e. market failure to adequate investment. Therefore, although I will not investigate the role of the EU's external energy governance in addressing the causes of market risks to external energy supply, the practical impact of the former on the latter would be similar as on the non-market risks.

284 'Turkey Halts Azeri Natural Gas Exports to Greece', *Hürriyet Daily News*, 26 April 2011 <http://www.hurriyetdailynews.com/default.aspx?pageid=438&n=turkey-halts-azeri-natural-gas-exports-to-greece-2011-04-26> [accessed 8 July 2013].

For a background for Turkey's past attempts to constrain the right of transit and charge excessive transit fees, see, e.g. Samuel Lussac, 'A Deal at Last: A Bright Future for Azerbaijani Gas in Europe?', *Central Asia-Caucasus Institute Analyst*, 28 April 2010 <http://old.cacianalyst.org/?q=node/5317> [accessed 4 December 2015].

285 ''Prague Summit Declarations: Southern Corridor'; 'The EU Energy Policy: Engaging with Partners beyond Our Borders, COM(2011) 539', p. 5.

286 *Caspian Development Corporation - Final Implementation Report*, p. 8.

287 Alec Rasizade, 'The Mythology of the Munificent Caspian Bonanza and Its Concomitant Pipeline Geopolitics', *Comparative Studies of South Asia, Africa and the Middle East*, 20.1 (2000), 138–47 (p. 142).

for Turkmen gas, the application of excessive transit tariffs can negatively affect the commercial viability of Turkmen gas in the EU markets. Therefore, if the TCP is to become a reality, then transit capacity and tariffs must be resolved beforehand all across the SGC, especially in Azerbaijan, Georgia and Turkey. While I analyse these risks in detail in the relevant empirical chapters, the current chapter presents the EU policy tools, which are relevant for addressing them via *institutional* mechanisms.

In general, the underlying factor that paves way to the emergence of transit risks, is the ability of the transit states to exercise *sovereignty* over their respective territories. Underpinned by the territorial sovereignty, transit states gain the ability to control, interfere with or even facilitate the flow of energy resources that crosses their territories in order to maximise national economic and/or (geo)political ends. In this regard, the territorial *sovereignty* is widely viewed as a *resource* to be exploited, just the same way as energy suppliers view energy as a resource.[288] To what end the *transit* role is utilised by the transit countries varies from country to country, depending on their strategic and economic goals. From the perspective of the consumer countries, on the other hand, the ultimate goal is to minimise or even entirely eliminate these transit risks in order to ensure free-flow of energy resources. The EC explicitly acknowledged the necessity of addressing transit risks *"if it is to have stable access to energy products it needs. This is especially true for gas, where the main risk lies in* ***transit conditions and continuing diversification of transport routes****, not in the status of world reserves."*[289]

Against this backdrop, EU's approach to addressing (market and) non-market risks to energy supply has revolved around the establishment of a functioning EU-wide single natural gas market by liberalisation and integration of the national markets of the individual member states. The EC Green Paper argued that, *"[s]ustainable, competitive and secure energy will not be achieved without open and competitive energy markets, based on competition between companies looking to become European-wide competitors rather than dominant national players, [which eventually] would bring down prices".*[290] Truly integrated liberalised natural gas market(s) and ensuing competitiveness is seen as the best defence against potential market and non-market risks to energy supply. Hence, underpinned by the *logic of calculus,* the EU's approach to addressing non-market risks is based on the deployment of *formal institutions* (market rules and organisational bodies), which

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[288] Yafimava, *The Transit Dimension of EU Energy Security: Russian Gas Transit Across Ukraine, Belarus, and Moldova*, p. 27.

[289] 'Green Paper - Towards a European Strategy for the Security of Energy Supply, COM (2000) 0769', p. 25 (emphasis added); *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, pp. 4, 6.

[290] *Green Paper: A European Strategy for Sustainable, Competitive and Secure Energy, COM (2006) 105*, p. 5.

envisages actions at two levels: *1)* Europeanisation of the EU domestic gas markets under *regulated-market principles,* and *2)* Export of the EU gas market model onto the main transit corridors and take advantage of its problem-solving properties beyond its sovereign territory.

2.1. Europeanising the EU's domestic gas market(s): liberalisation and regulation

Traditionally, gas markets in Europe were segmented into national markets, where individual country's supplies were provided by a dominant national incumbent company. The latter used to control supply (production and/or import from abroad) and transmission to the end consumers and ensured sufficient supply capacity for up to 20 years ahead.[291] These national champions commanded enough bargaining power and financial capacity vis-à-vis external suppliers and viewed themselves as the "guardians" of their national markets.[292] Although in itself, these conditions ensured adequate infrastructure (capacity) for meeting rising demand, inefficiencies and market concentration associated with them diminished competitiveness and resulted in higher natural gas prices compared to liberalised markets (e.g. UK and US). This is rather because, the mid-stream industry (incumbents) were entrusted with exclusive rights to supply national end-consumers, while downstream (end consumer) competition was only possible if the latter decided to switch to other relevant fuel types.[293] Furthermore, these national markets were characterised by limited physical external sources of supply. This was the result of the control of transportation networks by dominant external suppliers (and domestic incumbents) and long-term contracts that they had tied the national incumbents with, thereby obstructing competitive market forces.[294] In addition to economic consequences, it also carried strategic implications vis-à-vis external suppliers for the supply of energy was carried out by the states through external inter-governmental engagements.

Although natural gas market liberalisation in the EU was initiated in 1998 with the adoption of the first EU gas Directive (98/30/EC), 2007 gas sector enquiry by the DG

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291 Stern, *Security of European Natural Gas Supplies: The Impact of Import Dependence and Liberalisation*, pp. 22–23.

292 Finon and Locatelli, 'Russian and European Gas Interdependence: Could Contractual Trade Channel Geopolitics?', p. 427.

293 Correljé, Groenleer and Veldman, *Understanding Institutional Change: The Development of Institutions for the Regulation of Natural Gas Transportation Systems in the US and the EU*, p. 8; Cameron, *Competition in Energy Markets: Law and Regulation in the European Union*, p. 7.

294 Youngs, *Europe's External Energy Policy: Between Geopolitics and the Market*; Correljé, Groenleer and Veldman, *Understanding Institutional Change: The Development of Institutions for the Regulation of Natural Gas Transportation Systems in the US and the EU*, pp. 7–9.

Competition of the EC found that, competition in the gas market were limited largely due to, inter alia, market concentration, vertical foreclosure stemming from inadequate unbundling of network and supply, lack of cross-border market integration and overall transparency.[295] Although, there were many factors, which obstructed competition in the wholesale and retail markets, here I am more concerned with the risks related to access to transportation pipelines and cross-border "transit" of gas across the EU; in other words, "*transit"* risks, as they are more pertinent to natural gas transportation via the SGC.

The Commission inquiry found that, new entrants to the European gas markets often struggled with access to the transmission networks, as the transmission system operators in the EU were still controlled by the supply companies through vertical integration. This resulted in the discriminatory access regime to the main pipelines and constituted a major obstacle for the competitiveness, as well as the security of natural gas supply.[296] It created a barrier not only with regard to the access to national markets of the individual member states but also with regard to securing of third party access in key transit routes/pipelines across the EU.[297] In its ensuing legislative proposal the EC further argued that, *"[t]he emergence of vertically integrated natural monopolies (up- and/or downstream) exacerbates barriers to market entry, thus being an important obstacle to competition and efficiency gains. These vertically integrated companies have an incentive to hinder the entry and expansion of rivals in order to maintain their market power and thus achieve higher profits"*.[298]

Thus, in order to ensure competitiveness and security of gas supply, it was ultimately essential to ensure equal access of different suppliers to the emerging EU single gas market.[299] This was especially a stark issues in Central and East European countries, as high concentration of gas supplies in these region entailed security of supply risks, but also enabled monopolistic single supplier, i.e. Russian Gazprom, to set the price for the imported gas.[300]

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[295] *DG Competition Report on Energy Sector Inquiry SEC(2006) 1724* (Brussels: European Parliament/DG Competition, 10 January 2007), p. 4.

[296] *DG Competition Report on Energy Sector Inquiry SEC(2006) 1724*, p. 7.

[297] *DG Competition Report on Energy Sector Inquiry SEC(2006) 1724*, p. 8.

[298] *Commission SWD Accompanying the Legislative Package on the Internal Market for Electricity and Gas: Impact Assessment, SEC(2007) 1179* (Brussels: European Commission, 2007), p. 14.

[299] It is also important to clarify that, here the *"free-markets"* model does not necessarily denote *"neo-classical liberal"* market in which private actors operate free of governmental intervention. Quite the opposite, the EU's *"free market"* model is a heavily regulated space, within which certain segments (such as supply activities) encourage competitive/profit-seeking behaviour, while others (such as transmission services and access to it) are subject to public regulation.

[300] Svante E. Cornell, 'Trans-Caspian Pipelines and Europe's Energy Security', in *Europe's Energy Security: Gazprom's Dominance and Caspian Supply Alternatives*, ed. by Svante E. Cornell and Niklas Nilsson (Stockholm-Nacka: Woodrow Wilson Centre Press, 2008), pp. 141–55.

As a remedy, the EU adopted the Third Energy Package (TEP) in 2009,[301] in order to better address risks and to secure a competitive gas supply in the EU. Although, the package includes a variety of new measures with regard to the regulation of the EU natural gas market(s), the following three elements in the legislative package were specifically relevant to reducing "*transit*" risks:

(1) *Unbundling* - provisions are envisaged to de-couple the control over the supply/production, transmission and distribution segments of natural gas provision within the EU. This essentially means that, the companies who produce and/or supply gas (e.g. Gazprom, BP, Eni, Statoil, GdF, SOCAR, BOTAS, etc.) cannot at the same time own and/or wield control over the transmission lines.[302] This is conditioned by the fact that, transmission pipelines have a *natural monopoly* character, for if an existing supplier controls the access to the pipeline, it can be prohibitively costly for new entrants to build a new pipeline (or use other routes) in order to reach the same final customers.[303] Therefore, in order to ensure equal and fair access to the consumers, guarantee necessary investment into the transmission lines and foster competition by the new market entrants all across the EU, it was decided that suppliers cannot be entrusted with control, one way or another, over the transmission pipelines (or their operators). This is rather because there is an intrinsic conflict of interests between providing equal access for other suppliers to the pipelines owned by, e.g. the *company A* and the latter's own supply portfolio.[304] Thus, the EU opted for *ownership unbundling* (OU), *Independent System Operator* (ISO) and *Independent Transmission Operator* (ITO) models for unbundling *supply* from *transmission*, each of which ensures different, but still acceptable for the EU, levels of separation.[305]

(2) *Regulated (mandatory) third party access (TPA)* - provisions of the TEP are aimed at ensuring that, regardless of who owns/controls/manages the transmission pipelines, access to them are provided on an equitable basis. Regulated TPA sets a

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[301] In essence, the Third Energy Package consists of: Directive (2009/72/EC) concerning common rules for the internal market in electricity, Directive (2009/73/EC) concerning common rules for the internal market in natural gas, Regulation (EC) No. 713/2009 establishing an Agency for the Cooperation of Energy Regulators, Regulation (EC) No. 714/2009 on conditions of access to the network for cross-border exchanges in electricity, Regulation (EC) No. 715/2009 on conditions for access to the natural gas transmission networks.

[302] 'Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EC', 2009, Article 9.

[303] See e.g. Cameron, *Competition in Energy Markets: Law and Regulation in the European Union*.

[304] *Commission SWD Accompanying the Legislative Package on the Internal Market for Electricity and Gas: Impact Assessment, SEC(2007) 1179*, pp. 32–45.

[305] *Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas - The Unbundling Regime, SWD* (European Commission, 2010).

principle, where access to the pipelines are carried out based on pre-published tariffs, as opposed to negotiated tariffs between the pipeline operator and supplier (now called shipper).[306] The allocation of the capacity, on the other hand, is to be ensured though *auction* mechanism by default,[307] which enables all the interested shippers of gas to bid for the scarce capacity. Such a system allows the capacity to be allocated to those suppliers/shippers, who value it most, for the level of scarcity in capacity will determine the final pipeline access tariffs underpinned by classical supply and demand dynamics. Additionally, since auctions take place in a transparent manner, the risk of pipeline operator/owner/manager creating obstacles to the new market entrants (for commercial and/or political reasons) is eliminated altogether.

(3) *Equal treatment of gas in "transit"*[308] - last but not least, ensures that cross-border (*"transit"*) gas is not treated differently (unfairly) compared to gas destined for domestic consumers. By prescribing equal treatment of all shippers in the access to the transmission pipelines,[309] TEP benchmarks the tariffs for transit gas to the tariffs for domestic transportation of natural gas.[310] Therefore, to put it simply, member states of the EU can no longer charge extra fees to gas volumes crossing their territory to be delivered to customers in the neighbouring countries, while at the same time cross-subsidising the costs of the domestic customers.[311] This eventually allows gas to move freely within the integrated EU market without being subject to national barriers.

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306 'Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EC', Articles 32-35; 'Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on Conditions for Access to the Natural Gas Transmission Networks and Repealing Regulation (EC) No 1775/2005', 2009, Article 13.

307 'Framework Guidelines on Capacity Allocation Mechanisms for the European Gas Transmission Network' (Agency for the Cooperation of Energy Regulators (ACER), 2011); 'Commission Regulation (EU) No 984/2013 of 14 October 2013 Establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and Supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council', 2013.

308 In fact, the notion of "transit" was already abolished by the Second Energy Package in 2003. See e.g. Yafimava, *The EU Third Package for Gas and the Gas Target Model*, p. 3; Andrey Konoplyanik, 'Third EU Energy Package: Regulatory Changes for Internal EU Energy Markets in Gas and Possible Consequences for Suppliers (Incl. Non-EU Suppliers) and Consumers', *Oil, Gas & Energy Law Journal (OGEL)*, 9.3 (2011), p. 20.

309 'Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EC', Articles 32-35; 'Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on Conditions for Access to the Natural Gas Transmission Networks and Repealing Regulation (EC) No 1775/2005', Article 13.

310 Gokce Mete, 'Analysis of the Term 'transit' in Cross-Border Energy Transport: A Comparative Study of Regulatory Frameworks in the Eurasian Context', *Oil, Gas & Energy Law Journal (OGEL)*, 12.2 (2014), p. 26; *Transit Contracts in EU Member States: Final Results of ACER Inquiry* (Agency for the Cooperation of Energy Regulators (ACER), 2013), pp. 15–25.

311 Interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels. See also, *Transit Contracts in EU Member States: Final Results of ACER Inquiry*, pp. 15–25.

In a nutshell, the Third Energy Package prescribes regulatory measures designed to eliminate non-market risks to gas in transit and ensure equitable and transparent access to the main gas highways, hence fostering competitiveness in the markets. Physical market integration (facilitated by TEN-E guidelines),[312] additionally, will enable the new sources of gas to reach the consumers far from the entry point at the EU border and drive competition.[313] For example, the construction of the Bacton-Zeebrugge interconnector between the United Kingdom and Belgium forced Norwegian, Russian, UK gas and LNG into competition in a liberalised market context.[314]

To sum up, all these energy market blueprints are ultimately designed to ensure, inter alia, the sourcing of natural gas from multiple origins, without being subject to sovereign intervention, including during transit across different (member) states. Although the establishment of the SGC is expected to contribute to the better functioning and resilience of the liberalised EU gas market(s), the EU's regulatory design in itself does not address the transit risks beyond the EU borders. Indeed, both of the oft-cited supply disruptions from Russia occurred outside the EU's external borders in Ukraine in 2006 and 2009. Similarly, the Southern Gas Corridor envisages bringing gas volumes from different sources far from the EU borders, i.e. Caspian Basin and the Middle East and traverse across multiple transit jurisdictions, while potentially being subject to political and/or commercial transit risks. Therefore, addressing these risks along the supply corridor are just as important as regulating EU markets. In physical terms, the SGC is not confined to separate pipelines, but also encompasses the transit capacity of the national transmission systems of the transit countries.[315] Therefore, the policy actions undertaken must be able to address these risks at the system level and not only with regard to individual pipelines along the SGC.

2.2. External spillover of energy Europeanisation

In the Second Strategic Energy Review, the European Commission argued that, *"Europe should develop a new generation of '**energy interdependence**' provisions in broad-based agreements with producer countries outside Europe. […] Transit arrangements must be agreed to guarantee normal flows even in periods of political tension [… and] should be*

312 'Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on Guidelines for Trans-European Energy Infrastructure and Repealing Decision No 1364/2006/EC and Amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009'.

313 'Energy Infrastructure Priorities for 2020 and Beyond - A Blueprint for an Integrated European Energy Network, COM(2010) 677'.

314 Nies, *Oil and Gas Delivery to Europe: An Overview of Existing and Planned Infrastructures*, p. 53.

315 For example, 2011 intergovernmental agreement between Azerbaijan and Turkey envisaged the transit of Azeri gas to Europe via a new standalone pipeline (TANAP) or Turkish national transmission system.

based on the EU's energy acquis *where appropriate and the principles of Energy Charter Treaty. The provisions should contribute to a long term political framework, reducing political risks and encouraging commitments by private companies on* ***supply and transit****".*[316] In that regard, the EC indicated that legally binding provisions on energy interdependence should be integrated into the *new agreements* that will succeed the Partnership and Cooperation Agreements currently in place with third countries.[317]

In this context, the Prague Summit declared the SGC as a *synergy* of different policy instruments, inter alia, EU-Azerbaijan, EU-Georgia Partnership and Cooperation Agreements, Association Agreement with Turkey, European Neighbourhood Policy/Eastern Partnership, EU-Azerbaijan memorandum of understanding on energy and other bilateral and multilateral arrangements initiated and/or signed by the EU and relevant third countries.[318] Such a broader conceptual approach to the SGC reveals two important elements in the EU strategy to addressing external challenges to its gas supply security: 1) *external energy governance* is the preferred (and possibly the only available) tool in the EU's strategic energy toolbox, and 2) external energy governance is so important to the well-functioning and the freedom of transit through the SGC that constitutes its integral dimension.[319]

Although the EU dresses up its energy rule export policy as an attempt to raise the standards of international partners,[320] its rational implications on redistributing the *power* relations between the EU consumer and non-EU supplier/transit country lie much deeper. In this vein, being more than a mere international agreement, the *interdependence* that the EU is envisioning with third countries, including with those along the SGC is not that of international co-operation between the two independent actors, but an *external dimension of the EU internal energy market governance.* As highlighted in Chapter I, the mechanisms for the export of the EU's energy *acquis* are institutionalised *hierarchic* and *network* modes of external governance, where the EU rules are directly applied to third countries based on membership conditionality (e.g. Turkey) or the adoption of the EU rules occurs through "voluntary" negotiations and commitments (e.g. EaP countries - Georgia and Azerbaijan). In both cases, nevertheless, existing EU institutions (norms) serve as a template for the organisation of the energy markets in third countries, while addressing the external

316 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781', p. 8 (emphasis added).

317 'Second Strategic Energy Review: An EU Energy Security and Solidarity Action Plan, COM(2008) 781', p. 8; *Council Conclusions on 'Second Strategic Energy Review - An EU Energy Security and Solidarity Action Plan'*, p. 3.

318 'Prague Summit Declarations: Southern Corridor', p. 2.

319 *Energy 2020: A Strategy for Competitive, Sustainable and Secure Energy, COM(2010) 639*, pp. 18–19.

320 'The EU Energy Policy: Engaging with Partners beyond Our Borders, COM(2011) 539', p. 9.

energy supply risks in line with the EU preferences. In practical terms, the export of the EU *acquis* is operationalised via *bilateral, multilateral*, as well as *project specific* avenues. I explore each of these avenues and corresponding instruments below.

2.2.1. Bilateral institutionalisation

Export of the EU *acquis* through bilateral channels is prevalent in all the EU-third country relations, although the Union favours synergies with multilateral frameworks, especially with the Energy Community Treaty (EnCT).[321] The most specific institutional avenues with regard to the SGC countries are the accession process for Turkey and the ENP/EaP. In the framework of the ENP/EaP among the SGC countries, the EU is leading negotiations on the Association Agreement (AA) with Azerbaijan and has already concluded one with Georgia.

To start with, Turkey's institutional relations with the EU are rather asymmetric due to its EU candidate status. The country became a candidate country in 1999 and started its EU accession negotiations in December 2014, after it managed to sufficiently meet the minimum political conditionality (dubbed *Copenhagen Criteria*), which was set at the 1993 Copenhagen meeting of European Council.[322]

As part of the EU accession process Turkey has to transpose all of the 35 chapters of the EU *acquis communautaire* into its domestic legislation and harmonise its rules and policies with that of the EU, where the community policy-making exists. Turkey's relations with the EU, thus, follows a hierarchical mode of the latter's external governance, for the entry requirements are set by the EU and any country willing to join the club has to fully comply with them without having the flexibility to bring its own agenda or interests to the negotiations table. This, as a result, entails the wholesale export of the EU rules to Turkey, while the latter having say only in the timing as opposed to the depth of implementation of the EU rules.[323] In this case, the rule expansion takes place in a vertical - top-down manner, which gives the EU the leverage to ensure the success of its external governance. For these reasons, as an EU candidate country Turkey is more *asymmetrically* exposed to the influence of the EU rules than the partner countries under the Eastern Partnership (which I will analyse in the following section). Since the ultimate reward, membership in the EU, depends on the full compliance with the EU rules, the monitoring of which takes place at

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321 'Eastern Partnership COM(2008) 823' (European Commission, 2008), p. 5; 'The EU Energy Policy: Engaging with Partners beyond Our Borders, COM(2011) 539', p. 7.

322 Frank Schimmelfennig, Stefan Engert and Heiko Knobel, 'The Impact of EU Political Conditionality', in *The Europeanization of Central and Eastern Europe*, ed. by Frank Schimmelfennig and Ulrich Sedelmeier, Cornell Studies in Political Economy (Ithaca, NY: Cornell University Press, 2005), pp. 29–50 (p. 41).

323 Interview with an EU official at EC/ DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

the judicial level. Therefore, the enlargement process constitutes the most powerful *external tool* for addressing external risks (to energy supply) through their absorption in the expanded EU regulatory sphere.

For Azerbaijan and Georgia, on the other hand, the export of the EU *acquis* is in a *negotiated mode*, as they do not have EU candidate status and the former has not even indicated its willingness for the EU membership in the foreseeable future.[324] Nonetheless, regardless of the membership prospects, the Association Agreements attempt to ensure the application of the EU legislation in the partner countries, without providing membership reward in return. Essentially, this is a process of external Europeanisation under the *membership line*.[325]

From the perspective of the SGC and the elimination of the transit risks therein, EaP and the AAs creates a legal framework for the application of the Third Energy Package in the non-member and non-candidate transit states of the SGC. This includes the above-mentioned regulatory benchmarks – *unbundling*, *TPA* and natural gas *transit* rules. It provides a new institutionalised avenue where rule transfer can be enshrined in formalised, structured and if successfully signed, legally binding agreements, i.e. Association Agreements.[326] If fully implemented, unbundling, TPA and transit rules will eliminate or minimise non-market transit risks to energy sourcing from the Caspian Basin via the SGC, while effectively diminishing the transit governments' (i.e. Azerbaijan and Georgia) ability to tailor energy exports to their strategic and commercial interests. Such a grand *scheme* will ultimately affix the future single EU natural gas market with those of neighbouring countries up to the source of energy supply, while leaving little, if any role for political (or quasi-state) intervention in to the energy haulage.[327]

Furthermore, since the EU legislation prescribes liberalised market governance in energy supply, the AA agreements will pave the way for the commitment by the Eastern Partners to allow market pricing prevail for both domestic and transit gas, thus leading gas volumes to follow the market signals along the value chain. Hence, the ENP/EaP envisions not only the extension of intra-European cooperation, efficiency and environmentalism beyond the borders, but also the elimination of external disturbances through absorption of the players along the Southern Gas Corridor into a common institutionalised structure through which the EU can pursue its energy interests in a *preferred setting* - binding everyone to the rules of its own creation. In fact, according to some experts, energy

[324] Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.
[325] Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.
[326] Interview with a senior Georgian diplomat from the Georgian Mission to the EU, 16/04/2015, Brussels.
[327] For a broad conceptual argument, see e.g. Lavenex, 'EU External Governance in "Wider Europe"', p. 693.

motivations were central in the design and promotion of the ENP/EaP by the EU.[328] Due to the centrality of the EaP to the empirical analysis in this thesis, I will further investigate the rule selection, institutional organisation and the compliance mechanisms within the EaP later in this chapter.

2.2.2. Multilateral institutionalisation

The EU has been pursuing different multilateral initiatives since the mid-1990s in order to foster market integration and convergence in the broader Caspian region. The longest-running instrument, in this regard, has been the *INOGATE* programme (**IN**terstate **O**il and **GA**s **T**ransportation to **E**urope) established in 1995, the primary objective of which is the *"convergence of energy markets [in participating countries] on the basis of the **EU principles**"* through bilateral and cross-border technical assistance.[329] In addition, the EU and the broader Caspian region states lunched the *Baku Initiative* in 2004, in order to streamline the regional market convergence *"on the basis of EU internal energy market principles taking into account the particularities of the Partner Countries".*[330] This was to be achieved, inter alia, through *"[g]radual opening of the internal electricity, oil & gas markets, establishing independent energy regulators [and] establishing common methodologies for tariff setting policy/role of regulators for gas & electricity markets, based on the EU principles".*[331] With these goals the EC was keen on exploiting these instruments in widening its regulatory space to include the neighbouring regions.[332] However, most of the policy objectives pursued under the *Baku Process* were absorbed by the EU Eastern Partnership policy, while the technical level cooperation was transferred to the INOGATE Secretariat.[333]

Against this backdrop, currently the major instruments at the EU's disposal in establishing institutional milieu for external energy supply are the Energy Charter Treaty (ECT) and the Energy Community Treaty (EnCT). Born out of the Energy Charter process in 1994, the ECT Article 7 was the first attempt by the European Union to address transit risks to

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328 See e.g. Youngs, *Energy Security: Europe's New Foreign Policy Challenge*.

329 'The INOGATE Programme and the Republic of Azerbaijan', 2012 <http://www.inogate.org/> [accessed 20 January 2013] (emphasis added); for a good historical overview, see also, Lussac, 'Ensuring European Energy Security in Russian "Near Abroad": The Case of the South Caucasus'.

330 'Ministerial Declaration on Enhanced Energy Co-Operation Between the EU, the Littoral States of the Black and Caspian Seas and Their Neighbouring Countries', 2006, p. 1 <http://ec.europa.eu/dgs/energy_transport/international/regional/caspian/doc/2006_11_30_astana_conclusions.pdf> [accessed 4 July 2015].

331 'Ministerial Declaration on Enhanced Energy Co-Operation Between the EU, the Littoral States of the Black and Caspian Seas and Their Neighbouring Countries', p. 5.

332 'The EU Energy Policy: Engaging with Partners beyond Our Borders, COM(2011) 539', p. 7.

333 Interview with an official from the EC/DG Energy, 04/06/2015, Brussels.

energy supplies from the former Soviet countries. Since the ECT and the first EU directive on natural gas market were being prepared in parallel and to a great extent aimed at implementing similar legal principles, their impact on the level of liberalisation and the freedom of gas transit was largely the same. On the flip-side, this also meant that as the EU energy *acquis* continued to evolve through the adoption of the Second and Third Energy Packages and currently prescribes more stringent rules for, e.g. access to transportation capacity, the ECT essentially remained the same since it entered into force in 1998.[334] Unlike the current EU energy *acquis*, the ECT (nor its negotiated but never adopted Transit Protocol) does not prescribe *unbundling* and *regulated TPA* rules for gas transmission activity, nor does it prohibit charging *transit fees* for gas in transit.[335] Thus, not only the ECT 1994 fails to provide the same level of protection to gas in "transit", but also by setting only the *minimum standards* for its members, it can be argued that ECT actually provides a safety net for protecting non-EU actors (whether public or private) against the "excessive" liberalisation of the current EU *acquis*.[336]

For example, during the negotiations on the SGC, Azerbaijani authorities were confronted on numerous occasions by the EU demands to apply EU rules domestically in order to ensure the freedom of transit for Central Asian gas across its territory. In addition to refusing these demands on various grounds related to the potential domestic costs (which I investigate in detail in the empirical Chapter VI), Azerbaijani authorities also referred to the already existing transit obligations[337] of the country under the ECT and argued the application of the EU *acquis* for the purpose of ensuring transit freedom unnecessary.[338] In other words, the pre-existing formalised institutional structure that Azerbaijan is embedded into, serves as a *strategic* setting through which the latter can "protect" itself from the dynamic external energy governance of the EU, which envisages balance of (soft) power re-alignments by binding third countries to the EU preferences in energy supply. As such, some experts have argued that, as an institution the ECT bestows favourable bias

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334 Konoplyanik, 'A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)', p. 284.

335 Mete, 'Analysis of the Term 'transit' in Cross-Border Energy Transport: A Comparative Study of Regulatory Frameworks in the Eurasian Context', pp. 23–26; Danae Azaria, 'Energy Transit under the Energy Charter Treaty and the General Agreement on Tariffs and Trade', *Journal of Energy & Natural Resources Law*, 27.4 (2009), p. 572.

336 Konoplyanik, 'A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)', p. 284.

337 As explained above, these transit obligations are not as stringent as the EU *acquis* and do not envisage general principles, like mandatory TPA, or practical mechanisms, like capacity auctions, in its definition of freedom of transit.

338 These discussions took place during the *Euronest Parliamentary Assembly: Committee on Energy Security (Fourth Meeting)* (Baku, 2013). Very limited minutes of the meeting can be found at http://www.euronest.europarl.europa.eu/euronest/cms/cache/offonce/home/committees;jsessionid=C8C904E451009C26DC06E85AE5AAB938 [accessed 4 July 2015]

upon the energy security and industrial interests of the EU, while leading to the exploitation of natural resources of the producer countries.[339] However, this one example of *transit* is a practical testimony as to how the continuity of (existing) formal institutions may still be preferable to actors bound by them, even if they incur considerable costs.[340]

The Energy Community Treaty, however, is a more strategic and dynamic instrument in the EU's external energy governance toolbox. The leitmotif of the EnCT is the extension of the *acquis communautaire* in to the contracting parties to the Treaty.[341] As such, the EnCT carries the objective of fostering the development of regional energy markets in the EU neighbourhood and their further integration into the EU internal energy markets. If implemented successfully, these regional markets will become parts of the single EU market *before* or *without* the accession of the contracting parties to the EU membership.[342] Established in 2005 on the basis of the Second Energy Package of the EU, the EnCT also envisages (but does not oblige) the updates and upgrades to the EU legislation to be adopted by the contracting parties as they are adopted by the EU member states.[343] Thus, in contrast to the ECT, which is bound and limited by the regulatory precepts of a certain temporal point, the EnCT is designed as a strategic gateway for the continuous marketisation of the EU rules in third-countries as they become available in the EU.

In addition, although the EnCT lacks judicial rule enforcement mechanism comparable to the European Court of Justice, its highest decision-making bodies, the Ministerial Council and the Permanent High Level Group, represent the EU interests at a "higher rate" than the contracting parties (third countries), who are the targets of expansion of the EU *acquis*. As such, the EU is represented at these bodies with 2 members, as opposed to 1 member of the contracting parties.[344] The non-compliance with the EnCT obligations (brought

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339 See e.g. *The Energy Charter Treaty: An East-West Gateway for Investment and Trade*, ed. by Thomas W. Wälde, International Energy and Resources Law and Policy Series (London: Kluwer Law International, 1996); Rafael Leal-Arcas and Andrew Filis, 'The Energy Community, the Energy Charter Treaty and the Promotion of EU Energy Security', *Oil, Gas & Energy Law Journal (OGEL)*, 12.2 (2014), p. 22.

340 For theoretical discussions, see e.g. Hall and Taylor, 'Political Science and the Three New Institutionalisms', p. 940.

341 'Treaty Establishing the Energy Community', 2005 <https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/2796177/Pages_from_2178178.pdf> [accessed 13 January 2014], Titles I-II.

342 See e.g. Rozeta Karova, *Energy Community for South East Europe: Rationale Behind and Implementation to Date* (Florence: European University Institute, Robert Schuman Centre for Advanced Studies, Florence School of Regulation, 2009).

343 'Treaty Establishing the Energy Community', Article 25; see also, Roman Petrov, 'Energy Community as a Promoter of the European Union's "Energy Acquis" to Its Neighbourhood', *Legal Issues of Economic Integration*, 38.3 (2012), 331–56 (pp. 7–10). For example, the EnCT countries agreed to the adoption of the Third Energy Package by the 'D/2011/O2/MC-EnG: Decision on the Implementation of Directive 2009/72/EC, Directive 2009/73/EC, Regulation (EC) No 714/2009 and Regulation (EC) No 715/2009 and Amending Articles 11 and 59 of the Energy Community Treaty', 2011.

344 Leal-Arcas and Filis, 'The Energy Community, the Energy Charter Treaty and the Promotion of EU Energy Security', pp. 25–26.

forward by the Secretariat, Regulatory Board or any other party), on the other hand, are reviewed at the Ministerial Council level, which can suspend the certain rights of any EnCT party in the case of serious and persistent breaches of the Treaty.[345]

From the broader external policy point of view, the external energy governance via the EnCT enjoys certain practical advantages compared to the enlargement process. This is underpinned by its flexibility in relation to the general *political conditionality* and the *normative* strings associated with the latter. As such, while the enlargement process requires the candidate countries to comply with the minimum standards related to the political governance, e.g. human rights, democracy and rule of law before opening up the discussions in *acquis* extension, the EnCT places the *acquis* extension at its *raison d'être* without defining the *political conditionality* as the first step in the external Europeanisation. In doing so, the EnCT avoids the general problem of alienation of the political and economic power-brokers within the target countries by undermining their power base via the conditions of political and social reforms.[346]

In sum, based on voluntary multilateralism these rule expansion mechanisms, especially the EnCT, serves as a key instrument for promoting EU's energy interests in third countries and addressing the energy supply risks based on the EU template.

On the one hand, although there is no direct formal pre-accession requirement,[347] the EnCT also plays a role of a "preparatory school" for the eventual membership.[348] For other countries, who do not have realistic EU membership prospects, on the other hand, the EnCT provides a voluntary multilateral tool to Europeanise non-EU countries below the *membership threshold*[349] and address the external risks through the deployment of domestic institutions beyond borders.

2.2.3. Project-specific institutionalisation

In the absence of the fully functional regulatory framework fostering *market principles* in the target countries, the EU's alternative tool is, what can be called, *project-specific* external governance. With regard to this, the most discussed natural gas pipeline, Nabucco

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345 'Treaty Establishing the Energy Community', p. 89; see also, Petrov, 'Energy Community as a Promoter of the European Union's "Energy Acquis" to Its Neighbourhood', pp. 5, 11.

346 Leal-Arcas and Filis, 'The Energy Community, the Energy Charter Treaty and the Promotion of EU Energy Security', p. 26.

347 Interview with a senior official from the EEAS, 21/04/2015, Brussels.

348 *Energy 2020: A Strategy for Competitive, Sustainable and Secure Energy, COM(2010) 639*, p. 17.

349 See e.g. Prange-Gstöhl, 'Enlarging the EU's Internal Energy Market: Why Would Third Countries Accept EU Rule Export?'

classic[350] incorporated an element of external governance. Being a standalone, dedicated pipeline of massive capacity, Nabucco *classic* was based on a stable regulatory framework aligned with the EU *acquis*. Although one of the signatories of the Nabucco intergovernmental agreement (IGA), namely Turkey was not and still is not a contracting party to the EnCT or a member of the EU, Nabucco *classic* was expected to provide equal and transparent rules for network access and tariff methodology for the entire route of the pipeline. As I have described in specific details in the empirical Chapter II, by being the front-runner of the SGC, from the regulatory perspective, Nabucco was essentially an extension of the EU's domestic gas market all the way to the Turkey-Georgia and Turkey-Iran borders.

Although the EU was not a party to the Nabucco IGA, the European Commission was leading the negotiations with Turkey on behalf of the member states, who signed the IGA and were to act as a "transit" route for the Nabucco pipeline. The Commission's direct involvement in the negotiations was not only conditioned by its extensive expertise, but also by the motivation to ensure that EU member states, who were to sign the IGA, would not stray away from the EU legislation in their Nabucco commitments. From the perspective of Turkey, as the former Turkish ambassador to the EU Selim Kuneralp put it, with the signature of the Nabucco IGA *"the alignment with the acquis [was] coming in through the back door".*[351] Such a project-specific Europeanisation of the SGC would ensure market-based energy *transit* to the EU based on an international treaty (i.e. Nabucco IGA), without requiring reforms in the domestic legislation, which would otherwise be too costly for the transit countries to implement at the system level. Nevertheless, although such a mechanism of rule export provides a less-costly avenue for external energy governance, it is limited to specific and single projects, which *also* crosses the borders of the EU. Therefore, in order to Europeanise the infrastructure projects outside the EU borders, multilateral and bilateral engagement of the EU with third-countries is deemed necessary.

To sum up, the Europeanisation of the SGC is aimed at reducing transit risks, while boosting competitiveness (affordability) of gas supply along this alternative energy corridor. Indeed, the establishment of (the EU-sourced) regulatory conditions along the SGC will ensure that, the flow/trade of energy is determined by the free-market principles,

[350] The original pipeline, dubbed here as Nabucco classic, was planned to have a capacity of 31bcm and stretch from Turkish-Georgian and Turkish-Iraqi border to Baumgarten gas hub in Austria.

[351] Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.

i.e. supply and demand signals, without non-market interference of the state actors concerned.[352]

In this regard, given that the Eastern Partnership policy of EU is the newest and the most comprehensive external governance tool (under membership line) in the EU's external affairs repertoire and which has been pursued in close synergy with the development of the regulatory institutions along the SGC,[353] the next section provides the analysis of the EaP in the context of the SGC. It is especially relevant given that, I will analyse the factors affecting the adoption/rejection of the EU rules by Georgia and Azerbaijan in the context of the intra-institutional dynamics within the EaP in Chapters V and VI.

3. The Eastern Partnership and the EU external energy policy

Since the latest enlargement in 2004 and 2007, the EU's external borders have changed considerably and the Union has become to neighbour with regions and countries, which previously were considered as distant regions. Consequently, due to the enlarged neighbourhood the EU has introduced a new approach to its relationships with the new sixteen neighbours via European Neighbourhood Policy (ENP).[354] Following its inception in 2004, the ENP has promoted different initiatives to construct the Union's relations with individual neighbours in a dense manner, virtually in every sector, however under the membership line.

In 2008 Poland and Sweden introduced an Eastern dimension to the ENP called Eastern Partnership, which encompasses neighbours to the East of the Union, namely, Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. In general terms, the main rationale and goal of the EaP is *"to create the conditions to* ***accelerate political association and deepen economic integration*** *between the EU and the Eastern European partner countries"*,[355] which, *inter alia*, includes comprehensive partnership in the field of *energy security*.

Officially lunched on May 7, 2009 at the Prague summit, the Eastern Partnership envisages deepening of association of the 6 above-mentioned neighbouring countries with the EU, while stopping short of offering the former the prospects of future membership. Officially

[352] This was especially highlighted during the interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

[353] See e.g. 'Eastern Partnership COM(2008) 823', pp. 7, 11.

[354] The European Neighbourhood includes Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, the Republic of Moldova, Morocco, the Occupied Palestinian Territories, Syria, Tunisia and Ukraine.

[355] 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13', p. 3.

speaking, the partner countries are free to choose the sectors that they would like to cooperate with the EU after "fulfilling" the fundamental tenets of European values, namely, democracy, human rights, rule of law and the rights of minorities. In general terms, the EaP focuses on the 3+1 issues that have been jointly agreed with the partners based on the "joint ownership" principle:[356]

- *Political association and economic integration,*
- *Enhanced mobility of citizens in a secure and well managed environment,*
- *Strengthened sector cooperation (including energy).*

The fourth element of the association is the Deep and Comprehensive Free Trade Agreement (DCFTA) that partner countries can negotiate with the EU and become part of the European single market. DCFTA follows the logic that simple market opening is not enough, as technical barriers will still constitute a major hurdle in boosting external trade. Thus, there is a necessity to achieve harmonisation of rules and practices which govern major aspects of production in target countries (EaP) and bring them closer to the standards and regulatory practices of the market to be joined, namely, the EU single market.[357]

While each of the above mentioned elements constitute an important aspect of the EU's external governance, I will concentrate on the *sectoral cooperation* and the DCFTA of the AA, where the EC envisions to include "**energy interdependence**" into the association agreements that should be in *"coherence with, inter alia, EU trade, competition and energy policies"*.[358] Here it is important to point out that, unlike the accession negotiations – where (ideally) the process steps are: *membership conditionality → wholesale export of the EU rules → rule adoption and compliance → accession to the EU* – the EaP is less straightforward in terms the *mechanics* of the partnership. In order to shed light on the partnership in energy sector under the EaP, below I assess several key questions: a) *What are the rules to be exported to partner countries? b) How does the rule expansion take place in organisational terms? c) What is the reward for rule adoption and how is compliance ensured?*

Addressing these questions is especially relevant for the explanatory purchase of the External Incentive Model, which underpins the logic of actions of third countries in adopting/rejecting the EU rules, including within the framework of the EaP. As such, the

356 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13', p. 5.
357 Michael Emerson, *Countdown to the Vilnius Summit: The EU's Trade Relations with Moldova and the South Caucasus* (European Parliament/Directorate-General for External Policies of the Union, January 2014), p. 17.
358 'Eastern Partnership COM(2008) 823', p. 7.

EIM places special importance on the relationships between the expected benefits (in the form of *reward*) of adopting the EU rules and the costs associated with it, which underpins the cost-benefit analysis by the relevant actors in an institutional context. For this reason, in order to analyse this very ***relationship*** between the expected costs and the benefits, it is vital to understand what are the ***costs*** and the ***benefits*** in practical terms in the first place, which is the main goal of the sub-sections below.

3.1. Density of rule exports and "conditionality light" under the EaP

In terms of the selection of the EU rules (legalisation), network governance and specifically the EaP, *in principle*, envisages voluntary selection and implementation of the EU rules by the partner countries based on the *"joint ownership"* principle. That is to say, it is up to the receiving party to decide on the areas it wants to cooperate with the EU and what rules it has to adopt to that end. In itself, such an initial conceptual precondition by default anticipates the export of EU rules to the partner countries.[359]

In conceptualising these aspects of the ENP Lavenex and Schimmelfennig note that, the EU's main instrument in engaging with the partner countries is "soft law" or *conditionality light*, where bilaterally agreed action plans aimed at *approximation* of legal standards, as opposed to legal *homogeneity,* constitutes the basis of interaction.[360] Of course, in the absence of sizeable *reward* (like membership prospects) it would be naïve on the part of the EU to expect that partners would be wholeheartedly ready to voluntarily embrace the EU standards and practices. Nevertheless, this does not preclude the EU from attempting to induce the partners to gradually harmonise their legislation with that of the EU while employing at times patronising "*this is good for you*" rhetoric.[361] Although the EaP countries officially retain their sovereignty in choosing among different parts of the EU (energy) *acquis*, Brussels is still interested in exporting as much of its legislation as it is feasible from political and economical viewpoint outside EU structures.[362]

In general, since the introduction of the EaP in 2008, the European Commission explicitly pointed out that, *"legislative and regulatory convergence is essential to the partners' progress in coming closer to the EU"*.[363] With a similar language, the Commission and the

[359] As is the case with the accession process, Eastern Partnership also entails opening and closing of chapters in sectors that the EU and individual partner countries want to cooperate on, which inevitably includes energy sector due to its vitality to economic development and political independence.

[360] Lavenex, Lehmkuhl and Wichmann, 'Modes of External Governance: A Cross-National and Cross-Sectoral Comparison', p. 820.

[361] Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.

[362] Youngs, *Europe's External Energy Policy: Between Geopolitics and the Market*, p. 2.

[363] 'Eastern Partnership COM(2008) 823', pp. 9, 11.

European External Action Service (EEAS) later reiterated that, the work with the EaP countries should be focused *"on enhancing **cooperation to integrate competitive energy markets with the EU market** through comprehensive energy sector reforms (policies, legislation implementation and regulation)."*[364] To put it into perspective, if the partner countries to the East are to integrate into the EU energy markets, and since that is exactly what is being offer as part of the EaP,[365] then they have to harmonise their domestic legislation with that of the EU *acquis*. The binding commitment to adopt relevant EU *acquis*, accordingly, is legalised in the AAs signed between the individual EaP countries and the EU following the bilateral negotiations. Although these negotiations with the EaP countries were not public, the finalised and signed AAs are publically accessible.[366]

Within the AAs, energy (specifically natural gas) is dealt under the *DCFTA* and *sectoral cooperation* chapters. The former deals with the trade aspects of energy (natural gas) provision and sets broader principles of the organisation of the gas markets in the individual EaP countries and the principles of the organisation of access regime to energy transportation facilities in their territories.[367] For analysing the density of rules to be export via the EaP, in this thesis I use the EU-Georgia AA/DCFTA as the main point of reference. This is primarily because, Georgia is an important transit country along the SGC and its Europeanisation has direct implications on the supply of natural gas to the EU via this alternative energy corridor, which is at the centre of analytical attention of this PhD. Secondly, although another transit/supply country along the SGC, Azerbaijan, never signed an AA with the EU, the kind of (Association) agreement it was offered by the EU was similar to the one offered to Georgia (, Moldova and Ukraine).[368] Hence, the EU-Georgia AA provides a good point of reference, which can be sufficiently attributed to the rest of the EaP in examining the density of rules to be exported (including the nature of *rewards* offered in return).

In this regard, the chapter on the trade-related energy provisions of the EU-Georgia AA/DCFTA prescribes a guaranteed *third party access* to the ***transportation facilities*** (defined as *"high-pressure natural gas transmission pipelines"*)[369] in Georgia. Furthermore, although the DCFTA section of the EU-Georgia AA does not specifically prescribe auction

[364] 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13', p. 14 (emphasis original).

[365] 'Eastern Partnership COM(2008) 823', p. 11.

[366] Out of 6 EaP countries, only Georgia, Moldova and Ukraine signed AA with the EU. Among these countries, only Georgia is a party to the Southern Gas Corridor. .

[367] See e.g. 'Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part' (Official Journal of the European Union, 2014), Chapter XI.

[368] Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.

[369] 'Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part', Article 210.

mechanism for the allocation of the capacity in the transmission pipelines, *per se*, it requires such capacity to be allocated through *"transparent and non-discriminatory criteria and procedures".* The tariffs for access to transport facilities, additionally, have to be *"objective, reasonable, transparent and shall not discriminate on the basis of* ***origin, ownership or destination*** *of the energy good".*[370]

In line with the EU *acquis*, it could be argued that the latter prohibits a differentiated (discriminatory) treatment of transit gas from domestic gas and forbids charging any transit fees for gas *transiting* Georgian territory. This is rather because, in setting the general principles of third-party access to transport facilities (e.g. *high-pressure natural gas transmission pipelines*) in Georgian territory, the Article 217 of the EU-Georgia AA does not differentiate between domestic and transit pipelines; it prescribes the same access tariff principles across the board, thus, eliminating the notion of transit.

However, Article 211 of the same chapter also prescribes that, *transit of gas* through Georgia should be ensured consistent with Georgia's international commitments under the Energy Charter Treaty, which does not prescribe mandatory TPA to transit pipelines, nor the elimination of the transit fees *per se*.[371] From this point of view, the implementation of the DCFTA in Georgia will not require any regulatory changes as far as the *transit* of gas across Georgia is concerned.[372] In the context of the Europeanisation of the SGC, this means that, DCFTA section of the EU-Georgia AA as such, will not lead to the harmonised market integration and gas transportation via the SGC in Georgia. Nonetheless, the Article 218 of same chapter also indicates that upon the accession of Georgia to the Energy Community Treaty, the provisions of the latter and/or relevant EU energy *acquis* will take precedence in case there is any conflict between the above-mentioned provisions of the DCFTA and the EnCT (including third-party access rules and transportation terms), hence necessitating new regulatory reforms.[373] In this vein, although detailed legal analysis of the regulatory regime to be in place in Georgia following the country's accession to the EnCT is beyond the scope of this thesis, it is nevertheless evident that, the EU *acquis* is envisaged to take precedence whenever there is a collision with the pre-existing regulatory regime in place in the EaP countries.

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370 'Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part', Article 217.

371 See e.g. Mete, 'Analysis of the Term 'transit' in Cross-Border Energy Transport: A Comparative Study of Regulatory Frameworks in the Eurasian Context', pp. 23–26; see also Azaria, 'Energy Transit under the Energy Charter Treaty and the General Agreement on Tariffs and Trade', p. 572.

372 Interview with an official from the Georgian Ministry of Energy, 03/06/2015, Brussels.

373 This was highlighted during the interview with an official from the Georgian Ministry of Energy, 03/06/2015, Brussels.

In addition, the harmonisation of the regulatory regime with the EU legislation is also prescribed as part of the *sectoral* cooperation (Title VI) under the EU-Georgia AA. Article 298 of the EU-Georgia AA states that, EU-Georgia cooperation in energy should cover *"the development of competitive, transparent and efficient energy markets allowing* ***third parties non-discriminatory access to networks*** *and consumers* ***following EU standards****, including the development of the relevant* ***regulatory framework****, as required"*.[374] In addition, the sectoral part of the AA binds Georgia to adopt the following EU natural gas directives and regulations listed in the ANNEX XXV[375] of the AA:

- Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas,
- Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions of access to the natural gas transmission networks, as amended by Commission Decision 2010/685/EU of 10 November 2010,
- Regulation No 994/2010 of the European Parliament and of the Council concerning measures to safeguard security of gas supply,
- Directive 2008/92/EC of the European Parliament and of the Council of 22 October 2008 concerning a Community procedure to improve the transparency of gas and electricity prices charged to industrial end-users.

The former three legislative pieces can be argued to constitute the backbone of the EU Third Energy Package and include all the detailed procedures and the benchmark measures outlined at the beginning of this chapter (*section 2.1.*). The provisions of these legislative acts are to be implemented by Georgia in accordance with the timeline agreed by the latter in the framework of Georgia's accession to the Energy Community Treaty. The AA envisages an alternative mechanism, too, for if Georgia's EnCT accession is not effective within two years of the entry into force of the AA, then the timeline of implementation of the above-mentioned legislative acts is to be determined by the EU-Georgia Association Council no later than three years after the entry into force of the AA.[376]

In this regard, although it is yet to be seen as to what extent the AA will be successful in aligning Georgia's natural gas legislation with that of the EU, its general scope is considerably dense and provides a practical measure for analysing the prospective costs

374 'Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part', Article 298 (emphasis added).

375 'Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part', Article 300.

376 'Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part', ANNEX XXV.

associated with their adoption. It is also worth nothing that, the *bilateral track* of the Eastern Partnership and its contractual outcome, i.e. the Association Agreement is the only legally binding document committing the Eastern partners to adopt the EU rules. Nonetheless, the extension of the EU rules to the EaP countries is also encouraged through the mechanisms of institutional interaction in the *multilateral track* of the EaP, as well, which attempts to promote the *legitimacy* of the EU rules, as opposed to following the principle of conditionality.

For example, the Euronest Parliamentary Assembly of the EaP (which plays a role of legislative oversight over the EU-partner country relationships) stressed that, *"the EU and the Eastern European partners concerned must ensure that their energy sector cooperation under future association agreements is in line with EU internal market rules"*,[377] which is essential *"to encourage competition and innovation, [and] mitigate the risk of abuse of dominant positions on the energy supply and distribution markets".*[378] Although, as I will explain in the next section, Euronest or other multilateral fora of the EaP do not adopt binding decisions for the EaP countries, the inclusion of the rule extension in their work programme was aimed at socialising the Eastern partners about the merits of the EU legislation.

Against this background, although the EU had offered an AA to all the members of the Eastern Partnership, unlike Georgia, Azerbaijan has chosen not to commit to such a dense and legally binding instrument.[379] Nevertheless, EU's external energy governance efforts vis-à-vis Azerbaijan has not been any different from Georgia, as far as the rule extension is concerned. Although the negotiations with partners were held behind the closed-doors, it was confirmed during my interview with the lead negotiator from the Mission of Azerbaijan Republic to the EU, that the chapter on energy in the EU-Azerbaijan AA negotiations included every aspect of legislative reforms, for the EU was keen on capitalising on its domestic experience in institutionally restructuring Azerbaijan's energy sector.[380] Therefore, the EU's external governance vis-à-vis all the members of the EaP has been similar across the board.

It is also important to note that the EU's external energy governance vis-à-vis the SGC pre-dates the EaP and the Association Agreements and has been on the horizon ever since the

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377 'Resolution On Energy Security in Connection With Energy Market and Harmonisation Between the Eastern European Partner and the EU Countries' (Euronest, 2013), p. 7.

378 'Resolution On Energy Security in Connection With Energy Market and Harmonisation Between the Eastern European Partner and the EU Countries', p. 6.

379 Andrew Rettman, 'Azerbaijan and EU Race to Agree "Modernisation" Pact', 27 September 2013 <http://euobserver.com/foreign/121592> [accessed 29 December 2013].

380 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

start of gas exports from the Caspian region. For example, the memorandum of understanding (MoU) in energy sphere that was signed between the EU and Azerbaijan in 2006 maintained that, harmonisation of the Azerbaijan's energy legislation with that of the EU *acquis* will be a significant step in the former's *"economic integration and deepening of political cooperation with the EU."*[381] With a view to step up the creation of an open energy markets, the EU advocated the strengthening of the ***role of institutions*** and setting up *"an Energy Regulatory Authority independent of the interests of the electricity and gas industry [and] electricity and gas transmission system operators; having the tasks referred to, and fulfilling the criteria contained in the relevant articles of the Electricity and Gas Directives with respect to their independence from other activities not related to transmission"* (*i.e.* unbundling electricity and gas networks).[382] Therefore, the AA is not a new effort in the EU's external energy governance repertoire in relation to Azerbaijan.

At this point, it is necessary to pay attention to an interesting and equally important aspect of the EU's *definition* of the volunteerism and "more-for-more" principle that underpins the EaP. On the one hand, the EU claims that, EU *"does not seek to impose a model or a ready-made recipe"*[383] onto the partners. On the other hand, however, the partners are expected to align their domestic legislation with the relevant parts of the EU *acquis* if they want to further their political association and economic integration with the EU. In this regard, it can be argued that, volunteerism in EaP becomes reduced to *timing* (of adoption of EU rules) rather than a benchmark of equality and independent choice in partnership. It follows a similar logic to Henry Ford's famous quote about the Model-T: "*Any customer can have a car painted any colour that he wants so long as it is black".*[384] Thus, from the EU's perspective, the *legalisation* element of external energy governance, i.e. selection of rules can be conceived as nothing more than a timeline for prioritising convergence of norms of the partner countries with that of the EU.

In a broader picture, EU's rule export policy can be argued to be a *neo-colonial* strategy, with concealed dominance over the partners without reciprocation by the EU, especially

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381 'Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy', 2006, p. 2.

382 'Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy', p. 7; see also, the Twinning programmes initiated between Azerbaijan and the EU in the framework of the ENP Walter Sandtner, *Twinning Project: Legal Approximation and Structural Reform in the Energy Sector of Azerbaijan*, 2009 <http://www.energy-community.org/portal/page/portal/ENC_HOME/NEWS/News_Details?p_new_id=2401> [accessed 26 November 2012].

383 'A New Response to a Changing Neighbourhood COM(2011) 303', 2011, pp. 2, 3.

384 Henry Ford, *My Life and Work* (Doubleday, Page, 1922), p. 72.

as regards membership prospects.[385] However, *acquis*-based external engagement with third-countries is conditioned by the very institutional constraints that the EU operates under in constructing its external (energy) relations. Rational-Choice Institutionalism describes that, although the preferences of actors (i.e. EU) are exogenous to institutional analysis,[386] their behaviour and potential strategies are restricted and shaped by the institutions they are bound with. Accordingly, as illustrated in section 3 of Chapter I, these institutional constraints are also practically observed with regard to the Treaty provisions limiting the external aspects of the EU energy competences. In this regard, if in the context of establishment of the SGC (one of) the aim(s) of the EU is to address the transit risks along this alternative energy corridor, then the institutional tools at its disposal are very limited. Any agreement that EU signs with third countries must be compatible with the EU treaties and secondary domestic legislation. Therefore, the use of EU domestic *acquis* as a legal instrument to address external (energy) challenges, which will bind both third countries and the EU, is not only rational, but also constraint-driven.

Given that the EU is not a sovereign nation-state in a traditional foreign policy sense, its external policy actions in natural gas sector can advance only up to the level as to reflect the intra-EU integration achieved so far (although it entails re-alignment of power relations vis-à-vis third countries). Hence, although the EU external energy governance can bear some similarities to the neo-colonial policies pursued by some international actors, I would argue that, it is conditioned by the domestic institutional milieu that is operating under, as opposed to the deliberate neo-colonial policy preferences *per se*.

Furthermore, the relevant *acquis* was developed in order to address similar problems within the EU in the first place. As one EU official put it, *acquis* is the *"skeleton and life-blood"* of the EU and therefore, offers a concrete model in dealing similar challenges beyond the EU borders.[387] This, consequently, makes external energy governance a rational policy choice for the European Union, while the EU *acquis* constitutes much of the legal skeleton of the Association Agreements offered to the EaP countries.

[385] Horký-Hlucháň and Kratochvíl, '"Nothing Is Imposed in This Policy!" The Construction and Constriction of the European Neighbourhood'; Korosteleva, 'The Eastern Partnership Initiative: A New Opportunity for Neighbours?', p. 7.

[386] Hall and Taylor, 'Political Science and the Three New Institutionalisms', pp. 939, 951; Pollack, 'Rational Choice and EU Politics', p. 45.

[387] Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.

3.2. Institutional organisation of rule expansion: bilateral and multilateral tracks of the EaP

In terms of the organisational structure of the rule expansion, the EaP envisages both bilateral and multilateral tracks of institutionalisation of the EU and partner country relations.

The bilateral track of the Eastern Partnership provides a bilateral avenue of cooperation between the EU and EaP countries, in order to reach the objectives of the EaP following the conclusion of the individual Association Agreements (which will define the depth and extent of individual partner countries' relations with the EU and entail legally binding obligations for either party around the negotiations table).[388]

Prior to the signature of the AA, EU-Georgia (and also currently EU-Azerbaijan) bilateral cooperation was (is) based on three-tier institutional cooperation mechanism: 1) Cooperation Council, 2) Cooperation Committees and 3) Cooperation Sub-committees. These institutions were created following the signature of the Partnership and Cooperation Agreements (PCAs) between the EU and the current members of the Eastern partnership in the late 1990s and provided a structured avenue for bilateral interaction in different spheres of cooperation.

Following the signature of the AA on August 30, 2014, the EU-Georgia bilateral institutions were upgraded in order to reflect the depth and the width of the new contractual arrangement between the parties. In this vein, the above-mentioned PCA institutions were replaced by:

- *The EU-Georgia Association Council* – is held at the ministerial level once a year. There is only one (single) Association Council, which encompasses both political, DCFTA, as well as the sectoral cooperation elements contracted under the AA.
- *EU-Georgia Cooperation Council* – is held at the deputy-ministerial level and can be held in different configurations, including trade.
- *Association Sub-committees* – covers the sectoral part of the AA and takes place at the experts level. Unlike the *Cooperation sub-committee* under the former PCA, the tasks of the Association sub-committee are bigger, because the AA covers more sectors and much more comprehensively than the PCA. Under the AA, there will be three types of sub-committees: a) A single *sectoral sub-committee* - will be comprised of clusters encompassing different sectoral chapters of the AA,

[388] Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.

including energy chapter; b) four *DCFTA sub-committees*; c) the rest of the AA will have their own sub-committees.[389]

These institutions will play a key role in the process of implementation of the AA obligations, including the approximation process in energy sphere, by Georgia and monitoring thereof by the European Union. As it was indicated in the previous section, the timeline and the depth of implementation of the EU energy *acquis* by Georgia is not prescribed by the energy chapter of the EU-Georgia Association Agreement. In the future, these issues will have to be discussed at the expert level in the energy cluster under the Association Sub-committee and the outcome will be reinforced by the EU-Georgia Association Council or Committee.[390]

With regard to Azerbaijan, the institutional mechanism for bilateral interaction will remain the same as provided for under the 1996 EU-Azerbaijan PCA, since Azerbaijani government decided not to sign an AA with the EU. Therefore, there will be less dense interaction at the expert level between Azerbaijan and the EU in the context of approximation of the former's energy legislation with the EU *acquis*.

The multilateral track of the Eastern Partnership is the first of its kind, which assembles representatives of all the EU member states and 6 partner countries in different arenas and at different levels. It is aimed at supporting the *"progress in partners' bilateral relations with the EU"* and envisions to:

- *"provide a forum to share information and experience on partners' steps towards transition, reform and modernisation",*
- *"facilitate the development of common positions and joint activities"*,
- *"foster links among the partners themselves"*,
- *"provide the setting for the systematic organisation of dedicated sessions [...] devoted to the presentation and explanation of the EU legislation and standards [.. and thereby contribute] to initiating a structured approximation process."*[391]

In conceptual terms, multilateral track does not entail any contractual obligations[392] and thereby, is of consultative nature. With a multi-layered and participative institutional

[389] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.

[390] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.

[391] 'Eastern Partnership COM(2008) 823', pp. 8, 9.

[392] Hrant Kostanyan and Jan Orbie, 'The EEAS' Discretionary Power Within the Eastern Partnership: In Search of the Highest Possible Denominator', *Southeast European and Black Sea Studies*, 13.1 (2013), 47–65 (p. 50).

framework,[393] it aims at socialising the 6 partner countries and persuading them about the *appropriateness* of the EU rules.

Table 4 - The multilateral track of partnership of the Eastern Partnership | Compiled by the author using publically available EU documents.

Biennial Summits of the EaP Heads of State & Governments	
Annual Meetings of the Ministers of Foreign Affairs	• Meetings can also be held at the level of individual ministers in other policy areas
4 Thematic Platforms Biannual meetings at the level of senior officials	• **PLATFORM 1**: Democracy, good governance & stability • **PLATFORM 2**: Econ. integ. & convergence with EU policies • **PLATFORM 3**: Energy security • **PLATFORM 4**: Contacts between people
EURONEST Parliamentary Assembly	• **Committee 1**: Political affairs, human rights and democracy • **Committee 2**: Econ. integ., legal approximation and convergence with EU policies • **Committee 3**: Energy security • **Committee 4**: Social affairs, education, culture and civil society

In institutional terms, multilateral track envisions fora at different levels of representation, ranging from biennial summits of the heads of states & governments to ad hoc meetings of small panels dealing with individual issues (see **Table 4**).

From the perspective of energy security and Europeanisation of the energy sectors of the SGC countries, the third thematic platform on *energy security* and *Euronest Energy Committee* are the most relevant multilateral fora to the theme of this chapter. In general, it seems like there is a bit of confusion between the EU and the partner countries about the overall purpose of the thematic platforms. While the EU has put the emphasis on approximation of the partner countries' energy legislation with that of the EU *acquis*,[394] partner countries clearly prefer to regard the platforms as a launching pad for cross-border projects that involve participation of more than one country.[395] The European Commission has been especially keen on encouraging *"structured approximation process"*

[393] Laure Delcour, 'The Institutional Functioning of the Eastern Partnership: An Early Assessment', *Eastern Partnership Review*, October 2011, p. 4.

[394] 'Eastern Partnership Platform 3 - Energy Security - Approved Work Programme 2012-2013', 2012, p. 2.

[395] 'Resolution On Energy Security in Connection With Energy Market and Harmonisation Between the Eastern European Partner and the EU Countries', p. 4.

of partner countries' national policies and legislation with that of the EU by organising dedicated sessions involving experts from both sides.[396]

Third Thematic Platform on energy security, was established during the Prague Summit of the inauguration of the EaP in May 2009, while the first meeting held in June of the same year. The meetings under this platform take place biannually, while its working programme is set for the period of two years. The working programme for each year is agreed by the EU and the partner countries and take into account their needs and interests. The working programme for the first period between 2009-2011 had set to pursue 4 core objectives:

1. Enhancing framework conditions and solidarity among partners,
2. Support for infrastructure development, interconnection and diversification of supply,
3. Promotion of increased energy efficiency and use of renewable resources,
4. Regulatory framework and approximation of energy policies.[397]

With a similar overall mission, the Euronest Parliamentary Assembly that involves 60 parliamentarian from the EP and 60 from the partner states (50 without Belarus) is geared towards maintaining democratic control over the progress of the Eastern Partnership.[398] It includes a special Committee on Energy Security that holds consultations and prepares reports, recommendations and declarations regarding the developments in the subject specific area.[399] Euronest energy committee's goals mirror those declared by the Thematic Platform 3[400] and strives to achieve them through sharing of legal practices at a legislative level.

3.3. The finalité of the EaP and monitoring the compliance

At the bilateral level, the EaP is based on *differentiation* and *more-for-more* principles, where although the EU's domestic *acquis* always constitutes a point of departure (as was discussed in the previous section), each partner country, *in principle*, is expected to bring its own interests and agenda to the negotiations table.

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396 This was also personally observed by the author, during the attendance of the 13th meeting of the Platform 3 on Energy Security, June 19, 2015, Brussels.

397 'Eastern Partnership: Platform 3 - Core Objectives and Work Programme 2009 -2011', 2009, pp. 1–3.

398 'Euronest Parliamentary Assembly: Constituent Act of the Euronest Parliamentary Assembly', 2011.

399 'Euronest Parliamentary Assembly: Rules of Procedures of the EURONEST Parliamentary Assembly', 2011, p. 11.

400 'Euronest Committee on Energy Security: Documentation File' (Euronest, 2012), p. 2 <http://www.europarl.europa.eu/meetdocs/2009_2014/documents/nest/dv/eap_energy_security_documentation_/eap_energy_security_documentation_en.pdf> [accessed 27 August 2013].

Traditionally, Europeanisation of third-countries under the external incentive model was based on the *membership* reward for compliant (candidate) countries. However, the reward for compliance for the EU conditionality, or as some call it, the *finalité*[401] of the partnership under the EaP or its contractual pinnacle, is rather vague. The joint declaration of the Prague Summit, which inaugurated the EaP, stated that the Partnership *"will be developed without prejudice to individual partner countries' aspirations for their future relationship with the European Union".*[402] The declaration adopted in the next summit in Warsaw in 2011 went further in acknowledging *"the European aspirations and the European choice of some partners".*[403] However, while promoting convergence with the EU rules and policies, the EU has so far successfully avoided offering the Eastern Partners a membership prospect.[404] Some even speculated that, the wording of the EU-Georgia AA has been chosen very carefully in order to avoid any future *rhetorical entrapment* in the face of enlargement fatigue.[405] Thus, the question is: ***What will be Georgia's (or Azerbaijan's) benefits in return to approximating its domestic energy legislation with that of the EU acquis?***

As I illustrated above, Georgia is to conduct energy reforms both under the *DCFTA* and the *sectoral* parts of the EU-Georgia Association Agreement. As a free trade agreement the DCFTA section deals with trade related matters, where the partner country commits to approximate its domestic legislation with the EU *acquis* in order to gain access to the single EU market. As the name suggests, the DCFTA establishes a free trade area between the contracting parties, which will allow them to benefit from increased bilateral trade and the economic prosperity it ushers in.

In this vein, although the natural gas related provisions of the trade-related energy chapter of the DCFTA is clear in outlining the reforms Georgia is to carry out, its direct benefits to Georgia's energy (natural gas) trade and security is less obvious. This is rather conditioned by the special and spatial characteristics of natural gas trade, which as I described in Chapter I, is infrastructure and geology dependent. Georgia does not have natural gas resources of its own and is dependent on gas imports from Azerbaijan and

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401 Korosteleva, 'The Eastern Partnership Initiative: A New Opportunity for Neighbours?', p. 2.

402 'Joint Declaration of the Prague Eastern Partnership Summit in Prague' (The Council, 2009), p. 5 <http://ec.europa.eu/europeaid/where/neighbourhood/eastern_partnership/documents/prague_summit_declaration_en.pdf> [accessed 30 August 2013].

403 'Joint Declaration of the Eastern Partnership Summit, Warsaw, 14983/11 PRESSE 341' (Council of the European Union, 2011), p. 1 <http://ec.europa.eu/europeaid/where/neighbourhood/eastern_partnership/documents/warsaw_summit_declaration_en.pdf> [accessed 18 January 2013].

404 Interview with a senior Georgian diplomat, who was part of the negotiations team on the EU-Georgia AA, 16/04/2015, Brussels.

405 Andrew Rettman, 'EU-Georgia Treaty Highlights Enlargement Fatigue', *EUObserver*, 8 June 2013 <http://euobserver.com/enlargement/120789> [accessed 30 August 2013].

Russia. Additionally, the Georgian government or the private companies do not own natural gas pipelines traversing its territory. Thus, the only role that Georgia plays in its interaction with the European Union as regards to natural gas trade is being a *transit* country on the way of Caspian gas exports to the EU. This transit role is also unidirectional and Georgia does not (and is not expected to) receive any gas volumes from the European Union, as the latter itself is import dependent. In this regard, it is not surprising that the trade-related energy chapter of the EU-Georgia AA/DCFTA almost entirely concentrates on the transit provisions of gas flow *through* Georgia, as opposed to gas trade *with* Georgia. Therefore, unlike trade in e.g. industrial or agricultural products, where Georgia is a party to bilateral interaction, there is virtually no reward for Georgia's energy reforms as far as trade-related energy chapter of the DCFTA is concerned.

Azerbaijan, on the other hand, is not even entitled to sign a Deep and Comprehensive Free Trade Agreement with the EU, for it is not a member of WTO, which was set as a precondition by the European Union.[406]

Secondly, since reforms in Georgia's natural gas sector is also envisioned under the energy chapter of the *sectoral* part of the EU-Georgia Association Agreement, it is also worth analysing potential reward that Georgia could benefit from in return to approximation with the EU *acquis* through this avenue, too. The EU-Georgia AA envisions bilateral cooperation in the sphere of energy, including on security of energy supply, scientific and technical level, promotion of energy efficiency and nuclear safety, etc.[407] Furthermore, the Eastern Partnership and the AAs also provide for the participation of the partner countries in the *functional* EU programmes and agencies.[408]

Energy sector specifically, the Eastern Partnership envisages the development of "**mutual energy support and security mechanisms**".[409] In organisational terms, major emphasis is put on integrating the Eastern neighbours into functional EU and EU supervised agencies, such as **Intelligent Energy Europe Programme** (IEE).[410] The European Commission launched the IEE programme in 2003, which aims at supporting and creating better conditions for organisations that are willing to invest in energy sustainability, renewable energy, energy-efficient buildings, industry, consumer products and transport. Similarly, at the multilateral level, the Third Thematic Platform on energy security also

406 'Eastern Partnership COM(2008) 823', p. 4.

407 ''Association Agreement Between the European Union and the European Atomic Energy Community and Their Member States, of the One Part, and Georgia, of the Other Part', Article 298.

408 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13', p. 4.

409 'Eastern Partnership COM(2008) 823', p. 11 (emphasis original).

410 'Eastern Partnership COM(2008) 823', p. 8; 'Eastern Partnership Platform 3 - Energy Security - Approved Work Programme 2012-2013', p. 6.

aims at facilitating access of the partners to the EU's **ManageEnergy** initiative, which has similar objectives as the IEE.[411] To that end, the implementation of certain legislative requirements constitutes a pre-requisite for participation in these programmes.

Last but not least, the EU has also voiced the possibility of financing of cross-border projects from the EU and affiliated funds in order to incentivise the partner countries to adopt its rules. Thereby, the EC expressed that the cooperation in energy sphere can also look into the *"possibilities for EIB financing for Southern [Gas] Corridor"*[412] and further logistical and financial support through ENPI funded INOGATE and Energy Community in legislative convergence and market integration.[413]

In this regard, the *finalité* of the sectoral partnership between the EU and the Eastern neighbours seems to be more *functional* (related to issues of common interest) than *institutional* (at least from the EU perspective). As such, this functional reward under the network mode of rule export of the EaP contrasts with the hierarchy mode of the EU's external governance, which offers integration of the *rule-adopters* into the decision-making institutions of the EU through the accession process. From analytical point of view, this means that the rational-choice to be made by the relevant actors (in our case, Georgia) in adopting the EU natural gas legislation will have to measure the costs of extensive reforms against the limited (and potentially irrelevant) benefits of the final reward. In this regard, as the level of integration into the EU terminates below the membership line (which has been the primary motivator during the enlargement process), the ability of the EU to induce the partner countries' legislative approximation to a high standard can also be expected to be inferior.[414]

3.3.1. Monitoring the compliance

The Eastern Partnership 2013 roadmap indicated that, *"Progress towards reforms will be assessed according to specific criteria which reflect the commitments already undertaken*

411 'Eastern Partnership: Platform 3 - Core Objectives and Work Programme 2009 -2011', pp. 4, 5.

412 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit - Bilateral Dimension, SWD(2012) 109' (European Commission, High Representative of the EU for FASP, 2012), p. 32.

413 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13 - Multilateral Dimension' (European Commission, High Representative of the EU for FASP, 2012), pp. 16, 17.

414 It is also worth pointing out that although the AAs with the EaP countries prescribe much denser regulatory harmonisation than the Stabilisation and Association Agreements (SAAs) that the EU is in parallel negotiating with the Western Balkan countries. However, unlike the AAs the SAAs maintains the membership prospects for the Western Balkan countries. See e.g. Emerson, *Countdown to the Vilnius Summit: The EU's Trade Relations with Moldova and the South Caucasus*, p. 22.

through the existing agreements between the EU and partner countries including those in ENP Action Plans/Association Agendas".[415]

An Association Agenda is a common document between the EU and the partner country and lists the priority areas of cooperation in the next 3 years, following the signature of the AAs. Although the document is important for defining the priorities, it is not legally binding and does not list legislative acts that the partner county is expected to adopt as part of the approximation with the EU *acquis*. The list of legislative acts to be adopted, which were agreed as part of the AA, is rather reflected in the National Action Plan of the partner country, which serves as a reference document for them on what needs to be done each year.[416]

These National Action Plans will not be monitored by the EU, which will produce its own Progress Reports every year based on the information the partner country submits to the EU and the EU's own monitoring through the EU delegations in the relevant partner countries. In this vein, although the partner country is not obliged to provide its own progress report, it is nevertheless, obliged to provide any information (e.g. draft laws, policy documents) that the EU might request. Although the AA does not specify the technicalities of the monitoring process, it is expected that relevant DGs from the European Commission will be involved in the relevant policy areas.[417]

Furthermore, although (in our case) Georgia is obliged to fulfil the general principles of the energy *acquis* it is bound to under the EU-Georgia AA, it is unlikely that it will fulfil all the technicalities in the reform process.[418] ***However, should Georgia decide not to fulfil its obligations or has not done it to the EU's satisfaction, what are the mechanisms of coercion under the AA?***

In case of non-compliance by Georgia, this will be flagged up in one of the institutions described in the previous chapter. However, there are no or very limited tools of coercion or punishment within the AA framework. As regards the rule adoption in energy sector is concerned:

- DCFTA includes measures that can restrict the partner country's access to the single EU market in case of non-compliance in the agreed timeframe and/or depth of harmonisation until the remedies are provided. However, non-compliance in once sector, e.g. natural gas, will not limit market access in all the areas of free-

[415] 'Eastern Partnership: A Roadmap to the Autumn 2013 Summit, JOIN(2012) 13', p. 4.
[416] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.
[417] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.
[418] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.

trade. In other words, as the Georgian diplomat put it, *"if we [Georgia] do not comply with energy acquis, we can still export apples to the EU market".*[419] Hence, the DCFTA does not provide for a critical pressure on the partner countries to force rule adoption across the board. In addition, since the energy (natural gas) exported to the EU via Georgia does not belong to the latter, there is no political and economic rationale for limiting the market access to natural gas in order to force Georgia into compliance. Indeed, the punishment of the non-compliant partner will hurt the EU more than the partner country.

- In sectoral part, on the other hand, there are no punishment and/or enforcement mechanisms, as the partnership is based on the 'good-will' of the partner countries. Obviously, this can entail political pressure in the political dialogue institutions - i.e. Association Council and Association Committee. However, the AA does not envisage anything in terms of sanctions.[420]

Thus, unlike rule adoption during the accession process, the EaP and its contractual outcome - Association Agreement do not envisage strict enforcement mechanism, which can be applied in case of non-compliance.

To sum up, although in broad strokes the EaP envisages the absorption of third countries into the EU's regulatory structure, as was the case during the Eastern enlargement, it stops short of extending its institutional boundary to include the Eastern neighbours. In this regard, any access granted to neighbours in a limited number of EU agencies and programmes are of functional character, as it does not envisage any competence at a decision-making level. From the viewpoint of the External Incentive Model, such a limited reward in return for extensive reforms by default envisages non-or-limited compliance by the targets of the EU rule extension policy depending on the nature of costs to them.

4. Energy Union and Energy Diplomacy Action Plan as a "watershed"

Close to finishing this research in 2015, the European Commission published its new *Energy Union* policy framework and the *Energy Diplomacy Action Plan* was adopted by the Council of Ministers of the EU. This followed the general failure (as I thoroughly investigate in the case-study chapters) of the existing EU external energy policy approach and the heightened EU energy supply risks following Russia's military intervention in the Eastearn Ukraine and the annexation of Crimea in summer 2014.

[419] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.
[420] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels.

Some experts dubbed Energy Union efforts a leap forward in the unified energy policy of the EU, with open calls for the necessity of establishing *European energy diplomacy* in order to address external challenges in a unified manner.[421] On the one hand, whether the Energy Union will become a watershed or not in the EU's external energy policy perspective, it is important to note that this PhD aims to investigate only the governance "phase" thereof. Hence, its relevance to the external governance literature remains valid and indeed, provides substantive empirical contribution to the limits of external energy governance as a tool for addressing energy security risks in and through third-countries.

On the other hand, however, there are serious reservations as to extent to which there is a change/transition to a more foreign policy type energy policy in the EU's engagement with third countries. As in previous policy documents, the Energy Union communication reiterates that, "*[e]nergy policy is often used as a foreign policy tool, in particular in major energy* ***producing*** *and* ***transit countries***".[422] Hence, in order to improve EU's *"ability to project its weight on global energy markets"*, the Union "*will work towards an improved global* ***governance system*** *for energy, leading to more* ***competitive and transparent*** *global* ***energy markets***".[423] The same communication goes on to specify that, "*where the EU negotiates agreements with countries that are important from a security of supply perspective, the Commission will seek as a priority to negotiate* ***energy specific provisions contributing*** *to the energy security, notably* ***access*** *to resources"*.[424] In terms of the language, the *new* approach to external energy supply does not necessarily differ much from the *old* approach, which places the key emphasis on reforming the *governance* systems in third countries and the reliance on the *markets*.

Admittedly, the Commission also refers to the establishment of "***strategic energy partnerships*** *with increasingly important producing and transit countries or regions such as Algeria and Turkey; Azerbaijan and Turkmenistan"*[425], without being clear as to what it means by *strategic partnership*. Although in reference to the Strategic Partnership on energy with Ukraine, it places considerable emphasis on conducting necessary energy market reforms in the country similar to the *governance* thesis.

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[421] Sami Andoura and Jean-Arnold Vinois, *From the European Energy Community to the Energy Union: A Policy Proposal for the Short and the Long Term* (Notre Europe Jacques Delors Institute, January 2015).

[422] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 6.

[423] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 6 (emphasis added).

[424] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 6 (emphasis added).

[425] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 7 (emphasis added); See also *European Council Conclusions (19 and 20 March)*, 2015, p. 2.

Similarly, the Energy Diplomacy Action Plan adopted by the Council of Foreign Affairs of the EU, puts the emphasis on the active use of "diplomacy" instruments in cooperating with third countries.[426] However, it is, too, unclear as to what should constitute the content of this external cooperation, whether with the SGC countries, Russia or other relevant third countries. Similarly, the nature of linkage between EU energy and foreign policy remains at best unclear.[427]

The review of the European Neighbourhood Policy in late 2015 provided some clues as to the EU's own perception regarding the success and the *limits* of external policy action based on EU norms and standards. It specifically highlighted that, "*[d]ifferentiation and greater mutual ownership will be the hallmark of the new ENP,* ***recognising that not all partners aspire to EU rules and standards****, and reflecting the wishes of each country concerning the nature and focus of its partnership with the EU*".[428]

In relation to partnership in energy, the review highlighted that, *"[t]he EU strongly relies on its neighbourhood for* ***safe****,* ***secure*** *and* ***predictable generation*** *and* ***transportation*** *of energy and therefore needs to strengthen its dialogue with partner countries on energy security and sustainable production."*[429] To that end, the EU will enhance *"full energy market integration"* with the EaP countries who have signed AA/DCFTAs with the Union, including Georgia. With other partners, too, *"[t[he EU should [...] pursue regulatory approximation [...] on sectors of mutual interest"*.[430] Hence, although the call for more "diplomatic" and "strategic" approach to external energy policy is more pronounced in the latest EU policy documents, the content and the nature of this "new approach" remain undefined. This becomes all the more obvious since the Treaties and the underlying division of competences (on energy, as well as the foreign affairs and the security policy) remain unchanged. Hence, for the purpose of this thesis I will not investigate these new policy developments in the relevant case study chapters.

5. Conclusion

The EU's Southern Gas Corridor strategy has more implications for the Caspian and Middle Eastern energy players than it is usually presented by the extant literature. The EU is in

[426] *Council Conclusions on Energy Diplomacy* (Brussels: The Council of the European Union, 2015).

[427] Shahrazad Far and Richard Youngs, *Energy Union and EU Global Strategy* (Stockholm: Swedish Institute for European Policy Studies).

[428] 'Review of the European Neighbourhood Policy JOIN(2015) 50 Final' (European Commission, High Representative of the EU for FASP, 2015), p. 2 (emphasis added).

[429] 'Review of the European Neighbourhood Policy JOIN(2015) 50 Final', p. 11.

[430] 'Review of the European Neighbourhood Policy JOIN(2015) 50 Final', p. 12.

need of alternative gas volumes from these regions in order to ensure its energy security in light of the declining indigenous production and high dependence on concentrated imports. However, this chapter argued that, the EU aims at diversifying natural gas supplies from the Caspian Basin and Middle East under *competitive* market conditions. The regulatory dimension of the SGC, hence, is aimed to ensure the competitiveness of the natural gas supply to the EU via this alternative energy corridor, by making energy supply subject to market dynamics, i.e. supply and demand signals, as opposed to political bargaining among the state and non-state actors involved.[431] This would help the EU to resolve the energy supply and transit challenges along the SGC through the deployment of the EU internal market rules externally. This, consequently, would limit the strategic and commercial *uncertainty* in the behaviour of the state and non-state actors in influencing the energy transit.

As such, the regulatory dimension of the SGC cannot be called *foreign energy diplomacy* in a traditional foreign policy sense. The EU is not a *state* and its external action capacity in energy is limited to the scope of the integration of energy policy domestically. In other words, the regulatory dimension of the SGC is only the reflection of the *internal* Europeanisation *externally*. This lack of EU competences in foreign energy policy, however, should not be pre-judged against the problem-solving capacity of the EU external energy governance vis-à-vis third parties. As I have demonstrated throughout this chapter, the density of the external Europeanisation is considerably high, both in relation to the selection of the EU natural gas rules to be exported (legalisation), as well as the institutional organisational of rule expansion process.

Indeed, successful implementation of the EU external energy governance, especially, the rules on *unbundling, TPA* and *energy transit,* have the potential to alter the international environment, that the Union interacts with, by affecting the parameters of the potential energy strategies of the non-EU transit and supply countries. Hence, in the absence of the classical *actorness* of the EU in international relations, the lack of conventional capacity for *external* action is being potentially compensated by absorbing the *external* into the *internal* (enlargement - Turkey) or extending the tenets of the *internal* beyond the sovereign borders without merging the two (association - ENP/EaP - Azerbaijan and Georgia). In both cases the backbone of external action is the deployment of the *in-house institutions*, which presents a rational choice and yields the most optimal results to feed into the EU preferences. Therefore, the practical external actions of the EU with regard to

[431] This was especially highlighted during the interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

the regulatory dimension of the SGC is in line with the central thesis of the Rational-Choice Institutionalism theoretical framework.

As I argued above, the choice of external energy governance as a foreign energy policy to deal with the external challenges is conditioned by the Treaty constraints that the EU is bound with, as opposed to neo-colonial *motivations*. Without prejudice to this argument, this chapter contended that, EU's external institutional strategy bears certain *geopolitical* implications towards the target countries. These geopolitical implications differ in *modus operandi* when compared to the strategies of other international actors; especially Russia, who has been using energy as a *physical* tool of power politics in a classical realpolitik. In contrast, the EU has been successful in dressing its external energy policies, as one expert put it *"in the finer cloaks of rules-based discourse".*[432]

In practice, however, through the spread of the domestic practices and policies beyond the borders, the EU external governance leads to the emergence of a regulatory *buffer zone* in the EU neighbourhood. This ensures the "*domestic level*" of safety in external energy supply, at times without the hassles of an enlarged membership structure. The emergence of this *buffer zone* has the capacity to change the balance of *power* in energy security *asymmetrically* in favour of the EU consumers. This would be underpinned by the ability of the EU to influence the behaviour of the actors beyond its border by gaining *institutionalised soft power,*[433] for the rules they will be bound with are made in the EU. Ultimately, the latter will limit the capacity of third countries to use energy supply/transit as a tool of their strategic policy-making. This, on the other hand, will diminish their relative national power vis-à-vis the EU.

However, one should not equate the rational policy choice by one actor (EU) towards the others (SGC countries) with the rational policy response by the latter. In this regard, as Chapter I of this thesis argued, what actually conditions the success of the EU external energy governance in relation to the SGC, is rather the inter-relations between the expected costs and benefits of the target countries. I analyse these inter-relations in the subsequent three empirical chapters on Turkey, Georgia and Azerbaijan, the territories of which constitute the main transit segments of the SGC.

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[432] Youngs, *Europe's External Energy Policy: Between Geopolitics and the Market*, p. 8; Konoplyanik, 'A Common Russia-EU Energy Space (The New EU-Russia Partnership Agreement, Acquis Communautaire, the Energy Charter and the New Russian Initiative)'.

[433] Here, the difference between *institutionalised soft power* and conventional *soft power* is that, while the latter is underpinned by the ideational influence over the third counties through the promulgation of one's informal ways-of-doing-things, the former uses formal rules to tie the preferences of third countries to the one's domestic preferences. Essentially, difference is between "*getting others to want what you want"* and *getting others contractually signed up to what you want* without resorting to material means of coercion, such as economic or military might. For *soft power* in a conventional sense, see Nye, *The Paradox of American Power: Why the World's Only Superpower Can't Go It Alone*, pp. 8–12.

CHAPTER IV: EUROPEANISATION OF TURKEY's NATURAL GAS SECTOR & SGC

1. Introduction

The core aim of this chapter is to analyse the degree to which the EU has been successful in Europeanising the natural gas sector of Turkey, which is a lynchpin actor along the Southern Gas Corridor. Although the existence and the on-going construction of the physical gas infrastructure across Turkey (will) constitute tangible progress in the physical development of the SGC and its contribution to the EU energy security, it will not address all the potential risks to gas supply via this corridor.

As discussed in detail in Chapter III, transit risks specific to the gas industry can be in the form of restriction of access to transit capacity for political and/or commercial reasons, as well as the lack of transparency in price formulation and/or excessive charges for transiting gas. Turkey is a vital transit country between the Caspian and Middle Eastern natural gas reserves on the one hand and the EU market(s) on the other. Hence, policies and (geo-)politics pursued by the Turkish government in the natural gas sector has the potential to render the transfer of the above-mentioned energy resources to the EU *uncompetitive*, in other words, not being subject to the free market principles.

As I have argued in Chapters I and III, since the *competitiveness* of energy supply constitutes one of the fundamental tenets of the EU's conception of energy security, it requires institutional level EU external actions. The latter manifests itself in the *regulatory dimension* of the SGC. In relation to the Turkish segment of the SGC, the regulatory level external action on the part of the EU is pursued as part of Turkey's EU accession process, as well as the its potential membership in the Energy Community Treaty, both of which envisage the harmonisation of the Turkish, inter alia, natural gas legislation with that of the EU. In this context, the investigation of the success or failure of the *institutional* convergence between Turkey and the European Union in natural gas sector, as well as the determination of the factors conditioning thereof is important for analysing the potential transit risks for gas supply to the EU via the SGC.

To that end, below I first analyse the degree to which Turkey has aligned its gas market legislation with the EU *acquis* as part of its accession process. Then, I continue to identify the factors that condition Turkey's choices (failure) to implement the relevant

institutional reforms. In doing so, I rely on the rationalist explanatory model of external Europeanisation based on external incentive and contend that, in light of the uncertain membership prospects, huge net domestic costs constitute the major factors that inhibit the Europeanisation of Turkey's natural gas sector.

Finally, I analyse the implication of the lack of regulatory convergence between Turkey and the EU on the current and future functioning of the SGC under *competitive* principles.

2. Europeanisation of the natural gas sector of Turkey

As presented in Chapter III, the export of the EU natural gas legislation to Turkey is being pursued through the latter's EU accession negotiations and the potential membership in the Energy Community Treaty. Both of these avenues of EU external governance envisage the adoption by Turkey EU Third Energy Package and are of research interest for me here. Nonetheless, I will largely concentrate on the accession process in this chapter due to its centrality to the Europeanisation of Turkey; although references to the EnCT will also be made.

In general, the EU accession process envisages both political and *acquis* conditionality, which Turkey has to fulfil as a candidate country in order to become a member. Unlike the former, the *acquis* conditionality follows a relatively straightforward route in terms identifying the nature of reforms that a candidate country needs to implement. In the natural gas sector, the *acquis* consists of all the (gas related) components of the EU Third Energy Package and other legislative acts pertaining the natural gas sector. Due to time and space constraints, it is impossible to screen the entire Turkish natural gas market legislation in order to analyse their compatibility with the EU *acquis*. Furthermore, not all the elements of the EU's energy *acquis* are relevant for ensuring the freedom of gas transit via Turkey (as part of the Southern Gas Corridor), which is the main analytical focus of this PhD. Therefore, below I concentrate on the three regulatory benchmarks (*unbundling*, *TPA* and the *transit* rules) that I have identified in Chapter III for the purpose of analysing the compatibility of Turkish gas market rules with the EU *acquis*.

To start with, the most fundamental piece of legislation that regulates the Turkish natural gas market is the *Natural Gas Market Law (NGML) No. 4646* adopted in April 2001. The Law initiated the liberalisation of the Turkish domestic natural gas market, terminated the

legal monopoly rights of the state owned incumbent Petroleum Pipeline Company (BOTAS) and enabled the private entities to engage in natural gas supply in Turkey.[434]

The NGML introduced licensing requirements for each of the gas market activity (i.e. *production, transmission, distribution, wholesale, importation, exportation, trading and storage*)[435] and restructured Turkey's domestic market in a complex manner. The relevant stakeholders in the Turkish natural gas market are:

- Ministry of Energy and Natural Resources - is in charge of the state policy on energy and the preparation of the necessary draft laws to be adopted by the Turkish parliament.
- BOTAS - is a vertically integrated undertaking, which owns and operates national transmission lines, as well as supplies 78% of the wholesale gas in Turkey.
- Energy Market Regulation Authority (EMRA) (and its Board) - is the relevant regulatory authority in charge of providing necessary licenses and certificates for the gas market activities, approving tariffs for, inter alia, gas transmission and preparing necessary network codes.

In the market, public and private suppliers (importers and/or domestic producers) supply gas to the wholesalers, which then trade and re-sell the gas volumes to the distributors by using the national transmission networks owned and operated by BOTAS. For transmission services BOTAS receives transmission fees. Final customers (households), on the other hand, buy their gas from the distributors.[436]

NGML prescribes *account* and *legal unbundling* of the Turkish natural gas transmission system operator, i.e. BOTAS until 2009.[437] In account unbundling, the vertically integrated company is required to keep separate accounts for its transmission and supply activities, while legal unbundling requires transmission and supply activities to be performed by separate legal entities (whether under the same parent company or by unrelated entities). Furthermore, under the NGML, BOTAS was envisaged to undergo ownership unbundling from 2009 onwards and perform only gas import and wholesale activities with no more

[434] *Deloitte Report: Turkey's Natural Gas Market Expectations and Developments 2012*, 2012, p. 10.

[435] 'Natural Gas Market Law, No. 4646' (Turkey, 2001), Article 6.

[436] Gulmira Rzayeva, *Natural Gas in the Turkish Domestic Energy Market: Policies and Challenges* (Oxford Institute for Energy Studies, 2014), p. 49.

[437] 'Natural Gas Market Law, No. 4646', Provisional Article 2; *Deloitte Report: Turkey's Natural Gas Market Expectations and Developments 2012*, p. 11.

than **20%** market share. All other assets of BOTAS, excluding transmission pipelines, were to be privatised.[438]

In this regard, although the EU *acquis* prescribes three - *ownership*, *ITO* and *ISO*[439] models for the unbundling of the supply, transmission and distribution activities, it nevertheless allows the member states to decide on which of these models to apply domestically[440] Therefore, by prescribing ownership unbundling for the natural gas supply and transmission activities, the Turkish NGML formally complies with the relevant provisions of the EU *acquis* on this specific benchmark.

Secondly, the NGML provides for a regulated (mandatory) third party access rules for the transmission pipelines, which as a general principle is enshrined in Article 4 of the Law. In addition and similar to the EU *acquis*, NGML prescribes transmission tariffs to be approved by the regulatory authority (EMRA) and TPA to take place based on these approved and pre-published tariffs,[441] as opposed to negotiations between the third parties and the transmission operator.[442] The detailed provisions of the TPA are provided for in the network code called *BOTAS Transmission Network Operation Principles* or simply *NOP*. Although NOP has made huge progress in providing equitable TPA regime to national transmission network within Turkey, it does not cover the access regime for gas *transiting* the Turkish national system. This is rather due to the fact that NGML does not recognise *transit* as a market activity, hence, NOP does not prescribe any regulatory measures to that end.[443] In other words, although NGML provides for a regulated (mandatory) third party access for domestic gas, it does not extend the same benefits for the gas transiting (traversing) Turkish territory, which is the *raison d'être* of the Southern Gas Corridor.[444]

Lastly, since *transit* of gas is not considered a market activity in its own right, it is not subject to regulation under the current gas market law in Turkey. This allows for the state to treat transit regime for gas under sovereign discretion and attune it to the country's (geo)economic and (geo)political interests. In a bigger picture this means that, liberalisation of the Turkish gas market is (partially) taking place without its integration

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438 'Natural Gas Market Law, No. 4646', Provisional Article 2; *Deloitte Report: Turkey's Natural Gas Market Expectations and Developments 2012*, p. 11.; This was also highlighted during the interview with an official from the EC/ DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

439 Independent Transmission Operator and Independent System Operator

440 See e.g. 'Commission SWP: Interpretative Note on Directive 2009/72/EC Concerning Common Rules for the Internal Market in Electricity and Directive 2009/73/EC Concerning Common Rules for the Internal Market in Natural Gas - The Unbundling Regime', 2010.

441 'Natural Gas Market Law, No. 4646', Article 11.

442 *Deloitte Report: Turkey's Natural Gas Market Expectations and Developments 2012*, p. 12.

443 This was also highlighted during the interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

444 This was also pointed out during the interview with an official from the EC/DG Energy, 04/06/2015, Brussels.

into the neighbouring, especially the EU single market. Additionally, when analysing the degree of rule adoption by Turkey, it is also important to investigate the practical implementation thereof in order to avoid the impact of *"Potemkin harmonisation"* on the functioning of the Southern Gas Corridor.

In this regard, contrary to the regulatory prescription, BOTAS has not yet undergone ownership unbundling and remains a firmly vertically integrated undertaking almost 15 years after the adoption of the Turkish NGML.[445] Furthermore, the market share of the Turkish gas incumbent BOTAS was reduced to only 78% by 2015 as opposed to 20% as prescribed by the NGML. BOTAS currently accounts for around 35 bcm/a of Turkish domestic gas supply, in comparison to 10 bcm/a by the private actors.[446] Additionally, through Board Decisions No. 725/2006 and No. 1709/2008 Turkish Energy Market Regulatory Board has introduced a new requirement according to which, BOTAS's comments must be received before the approval of the new gas purchase contracts, that private companies conclude with external suppliers with whom BOTAS does not hold import contracts. This decision is justified by *"the concerns regarding the "take or pay" obligations under the purchase contracts of BOTAS and the establishment of more-than-necessary import connections, and thus the need to take measures to prevent public losses."*[447] In other words, as a state-owned entity BOTAS is allowed to influence the commercial decisions of the private gas suppliers, which were supposed to be operating in a liberalised market.

In this regard, although Turkey has achieved some progress as regards the liberalisation of its domestic natural gas market, the progress has largely been oriented towards internal gas supply and avoided providing market-based regulatory regime as far as the transit gas is concerned. This puts Turkish national gas market legislation in conflict with the EU *acquis*, which envisages the establishment of an integrated energy market, where energy flows wherever it is needed most, without being subject to national barriers.[448] In this vein, as I demonstrated in Chapter III, the notion of gas "transit" under the EU law requires gas flow to be determined by the technical capacity and commercial considerations related to the transmission lines, rather than the (geo)political and (geo)economic considerations of the transit country. This principle has neither been prescribed in law, nor implemented in practice in Turkey, especially vis-à-vis the passage of the Caspian gas to the EU via the

[445] Interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

[446] Rzayeva, *Natural Gas in the Turkish Domestic Energy Market: Policies and Challenges*, p. 29.

[447] *Deloitte Report: Turkey's Natural Gas Market Expectations and Developments 2012*, p. 13.

[448] *A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy COM(2015) 80*, p. 2.

Turkish national transmission system (or even separate transit pipelines as I will indicate below).

The necessity of ensuring regulated equitable third party access regime to the Turkish pipelines is important to ensure that Turkey does not cross-subsidise domestically destined gas with the volumes traversing its territory en-route to the EU by charging the latter with higher transportation tariffs compared to the former.[449] This may not only dis-incentivise the supply of gas across the SGC, but also render gas volumes exported to the EU commercially uncompetitive due to the high costs stemming from the transportation/transit.

Similarly, in its recent progress reports on Turkey's compliance with the EU rules, the European Commission repeatedly indicated that Turkey has made no progress in ensuring *"fair and non-discriminatory rules for gas transit"*[450] and BOTAS, which also controls domestic natural gas transmission system, has not reduced its monopolistic domestic market share as was previously expected.[451] Following the tangible progress on the intergovernmental agreement with Azerbaijan on the Trans-Anatolian Pipeline, the European Commission praised Turkey for the *"progress in the field of energy, especially on* ***security of supply***". However, it stressed that, *"further work is required on natural gas [...] in particular on alignment with the relevant EU directives".*[452]

In the past, the lack of transit freedom across Turkey has created a number of setbacks for the transportation of Caspian, especially Azeri gas to the EU. Azerbaijan started production in its giant Shah Deniz gas field in 2006 and supplied its first gas volumes to Turkey in 2007 based on the supply contract signed in 2001.[453] Under this contract, the Eastern border of Turkey was used for the delivery and the pricing of gas volumes destined for Turkish consumption. Some of these volumes were later re-exported to the EU by Turkey at much higher prices, which caused dissatisfaction by the Azerbaijani side as regards the *unfair* gas purchase prices it was receiving from Turkey.

Following the emergence of the Southern Gas Corridor concept in 2008, the transit-hampering role of Turkey became all the more visible. Turkish government was keen on

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449 Interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

450 *Turkey 2012 Progress Report, SWD(2012) 336* (Brussels: European Commission, 2012), p. 61; *Turkey 2013 Progress Report, SWD(2013) 417* (Brussels: European Commission, 2013), p. 35. The lack of relevant progress was also highlighted by the official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels

451 *Turkey 2012 Progress Report, SWD(2012) 336*, p. 61.

452 *Turkey 2014 Progress Report, SWD(2014) 307* (Brussels: European Commission, 2014), p. 38 (emphasis added).

453 Lussac, 'A Deal at Last: A Bright Future for Azerbaijani Gas in Europe?'

acting as a middleman in transferring the Caspian gas, by purchasing it at low prices on its Eastern border and re-selling it at higher prices to the EU on the Western border.[454] Given that the Azerbaijani government was already unhappy with the gas purchase prices it was receiving from Turkey, it firmly declared its intention to sell its gas directly to the European customers by using Turkey only as a transit country.[455] It took Azerbaijan three years to negotiate the transit terms of its gas exports to the EU. Both on this issue, as well as during the negotiations on the transit regime for the Interconnector Turkey-Greece-Italy (ITGI) and Nabucco pipeline (which were to source, Azeri, Iraqi and Iranian gas at the Eastern border of Turkey for the delivery to the EU), Ankara's transit hampering role manifested itself on two specific points:

- **Transit lift-offs** - Turkey was keen on receiving 15% of natural gas transiting its territory free of charge or under discounted prices as a transit fee, in relation to both Nabucco[456] and ITGI.[457]
- **Cheap gas purchase prices** - The freedom of transit across Turkey was also linked to the (cheaper) gas purchasing prices for Turkish domestic consumption.[458]

These demands by the Turkish government were not acceptable for the Caspian producers, because any additional costs incurred during the transit would make their gas uncompetitive in the EU market. By undermining the commercial viability of the Caspian gas exports to the EU, Turkey's relentless transit terms also delayed the progress of the establishment of the Southern Gas Corridor for at least half a decade.

In this regard, the ability of the Turkish government to pursue its above-mentioned preferences was rendered legally and politically possible, as the Turkish government has not approximated domestic legislation with the EU energy *acquis*, which would have otherwise established a transit-friendly regulatory regime in Turkey. Neither Turkey's membership in the Energy Charter Treaty provides strong enough regulatory pressure; for the it does not prescribe regulated (mandatory) third party access regime to the

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454 Lussac, 'A Deal at Last: A Bright Future for Azerbaijani Gas in Europe?'

455 Interview with a senior official from SOCAR, 29/06/2015, Brussels.

456 Vladimir Socor, 'Turkey's Stalling on Nabucco Hurts Europe, Azerbaijan, and Itself: Part One', *Eurasia Daily Monitor*, 2009 <http://www.jamestown.org/single/?tx_ttnews%5Btt_news%5D=34657&no_cache=1#.VUShbq2qqko> [accessed 5 February 2015]; 'Nabucco Gas Pipeline Project Crosses Key Threshold with Signing of Intergovernmental Agreement', *IHS*, 13 July 2009.

457 Vladimir Socor, 'Interconnector and Trans-Adriatic Gas Pipeline Projects: How Competitive?', *Eurasia Daily Monitor*, 2011 <http://www.jamestown.org/regions/turkey/single/?no_cache=1&tx_ttnews%5Bpointer%5D=4&tx_ttnews%5Btt_news%5D=37358&tx_ttnews%5BbackPid%5D=649&cHash=9cdb7e997cfef26dbe3ac1330f452c25#.VUSjNa2qqko> [accessed 5 February 2015].

458 Interview with a senior official from SOCAR, 29/06/2015, Brussels.

transmission/transit pipelines, nor it prohibits the demands for transit fees by the transit country.[459]

Lack of conformity with the EU energy *acquis* can be witnessed not only in the Turkish domestic gas legislation, but also in the intergovernmental agreements that Turkey has signed as part of the specific transit projects for the export of the Caspian gas to the EU. In this regard, the Turkey-Azerbaijan intergovernmental agreement on the Trans-Anatolian Pipeline is very important, as it will constitute an important mid-stream segment of the current design of the SGC. The IGA and the Host Government Agreement (HGA) on TANAP were signed between Turkey and Azerbaijan on June 26, 2012, while the final investment decision on the construction of this pipeline was undertaken on March 17, 2015.

In contrast with the EU energy *acquis*, TANAP IGA does not envisage any unbundling or TSO certification provisions, while the pipeline is owned by SOCAR (58%), BP (12%) and BOTAS (30%); all these companies are engaged in the production and/or supply of natural gas. From the point of view of gas transit across Turkey, this is an especially relevant concern. This is rather because, freedom of transit across the SGC can only be achieved if the regulatory regime for the corridor is ensured in such a way that the ownership of gas volumes transported through the infrastructure(s) is irrelevant for the owners and the operators of this very infrastructure(s). In this regard, since the owners of TANAP also own the volumes transported through it, they have an in-built conflict of interest with other potential gas producer/suppliers in the region, who might be interested in having access to the TANAP's capacity, whether to supply Turkish or the EU consumers.

Additionally, TANAP IGA does not prescribe regulated (mandatory) third party access in accordance with the EU *acquis,* either*,* although negotiated third party access is not ruled out. The latter will be dependent on the business model of the operation of TANAP and the profits that third party gas can generate for the owners of the pipeline in the case of the availability of the free capacity in the pipeline.[460]

Moreover, TANAP HGA grants TANAP Project Entity the exclusive right to conduct the transit passage of natural gas via the Trans-Anatolian Pipeline.[461] Under the HGA, the Turkish government has undertaken the obligation not to obstruct Azeri gas exports to the EU. However, in return, any future available gas from Azerbaijan (in addition to SH II volumes) will first have to be offered to the Turkish market and only then to the EU

[459] See e.g. Mete, 'Analysis of the Term 'transit' in Cross-Border Energy Transport: A Comparative Study of Regulatory Frameworks in the Eurasian Context'.

[460] Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels. Similar view was also voiced by the EC/DG Energy official during the interview, 03/05/2013, Brussels.

[461] Babayev, 'TANAP: General Project Status'.

consumers.[462] This is incompatible with the EU natural gas market principles, which envisages gas to follow price signals, as opposed to political promises.

In this regard, although TANAP IGA and HGA provide a certain level of secure transit of Azeri gas through Turkey, it is not in compliance with the EU energy *acquis*. In the absence of regulated third party access, the control of the pipeline by a limited number of producer companies will create a major conflict of interest in the future. This is rather because, Turkey and specifically, TANAP can also serve as a transit route for the export of Middle Eastern gas volumes (from, e.g. Iran, Iraq or even Turkmenistan in Central Asia) to the EU, in addition to Azeri gas. Control of TANAP by the upstream companies producing gas in Azerbaijan, however, would enable them to exercise the right of first call for the access to the pipeline or even result in excessive access charges for third party gas. In this regard, the legislative framework behind TANAP does not provide for legal safeguards for non-discriminatory and equitable access rights for third parties, which is the backbone of the EU energy *acquis*. Quite interestingly, by signing up for TANAP, Turkey has conceded and shared some its sovereign transit prerogatives with Azerbaijan. Nonetheless, as argued above, these prerogatives oblige Azerbaijan to offer future available gas volumes to Turkey first and only after to the EU markets. Additionally, these prerogatives do not extend to providing freedom of transit for all other interested parties, including Iran, Iraq and Turkmenistan.

In contrast to TANAP, the Nabucco IGA (described in Chapter II) provided for a mandatory third party access to 50% of the capacity of the pipeline. In doing so, the IGA prescribed *One-Stop-Shop Shipper access* regime to the pipeline,[463] while eliminating any Nabucco specific transit taxation and prohibiting any hurdles regarding the geographical delivery point of gas[464] or the *"interruption of or restriction on the freedom of transportation in the Nabucco Project"*.[465] In doing so, although Turkey was (and is) not a member of the EU, it was (is) bound by the provisions of the Nabucco IGA, which was in compliance with the EU energy *acquis* at the time.[466] However, since Nabucco Classic pipeline is off the table now, its favourable transit regime is of little relevance for gas transit across Turkey.

In the following section I aim to provide a thick description of the domestic factors that have so far conditioned the failure of rule adoption by Turkey and its implications on the regulatory dimension of the Southern Gas Corridor. I will deploy the External Incentive

[462] Interview with the official from SOCAR, 29/06/2015, Brussels.
[463] 'Intergovernmental Agreement on Nabucco', Article 3.3.3.
[464] 'Intergovernmental Agreement on Nabucco', Article 7.1 and Article 11.1.
[465] 'Intergovernmental Agreement on Nabucco', Article 7.2.
[466] 'Intergovernmental Agreement on Nabucco', Article 3.3 and Article 13.

Model (rooted in Rational-Choice Institutionalism) in order to reveal the underlying factors affecting the failure of rule adoption. This model predicts that, "*A government adopts the EU rules if the benefits of EU rewards exceed the domestic adoption costs*".[467] With this in mind, the following sub-sections will analyse the role of *size and speed of reward, credibility of conditionality* and the *net domestic costs* in the failure of the EU-sourced energy reforms in Turkey. Investigation of these factors will not only help me to explain Turkey's choice not to implement EU rules domestically, but also set the institutional context for the potential implications thereof on the functioning of the Southern Gas Corridor.

2.1. EU-Turkey membership negotiations: the size and the speed of the final reward

Understanding Turkey's EU membership ambitions is essential in order to thoroughly appreciate its energy security strategy and its current and future impact on the development of the SGC.

To start with, Turkey's EU membership aspirations date back to almost 30 years ago, when the government at the time formally applied for the EU membership in 1987. Although the EU membership prospects were already mentioned in Article 28 of the 1963 (Ankara) Association Agreement with the EU, Turkey received a candidate status only more than 30 years later, at the Helsinki European Council in December 1999. The accession negotiations, on the other hand, were launched in December 2004, after the Turkish government progressed in implementing reforms to comply with the EU's Copenhagen (political) criteria.[468] Although almost 10 years have passed since the start of the accession negotiations, Turkey still seems to be a long way off fulfilling the EU's *acquis* conditionality. Out of 33 chapters of the EU *acquis communautaire,* which Turkey has to align its domestic legislation with, only 14 have so far been opened and only 1 chapter (the non-controversial science and research) has been provisionally closed. 8 chapters were blocked by the EU Council in 2006. Additionally, 5 chapters were blocked by France in 2007 and 6 additional chapters (including energy) were unilaterally blocked by Cyprus in 2009, because of Turkey's position on the conflict resolution in the island. France unblocked 1 chapter on *regional policy* in 2013, although the chapter has yet to be opened

[467] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 12.
[468] Schimmelfennig, Engert and Knobel, 'The Impact of EU Political Conditionality', p. 41.

for negotiations.[469] The Council's decision to block 8 chapters was triggered by Turkey's failure to implement the Additional Protocol to the Association Agreement, which is related to the obligation of Turkey to open its air and seaports to Cypriot planes and shipping.[470] Energy chapter, on the other hand, was blocked by the Republic of Cyprus; because the Turkish navy obstructed the Cypriot government from carrying out oil and gas exploration in parts of the Mediterranean, which the latter considers its exclusive economic zone (EEZ). For its part, Ankara insists that exploration of hydrocarbons can only be allowed after the unification of the divided island in order to ensure that both communities (Greek and Turkish) could benefit from the potential offshore drillings.[471]

In light of these developments, despite its continuous reiteration about the commitment to the EU membership (the policy course, which the former Turkish foreign and currently Prime minister Ahmet Davutoglu called "irreversible"),[472] the Turkish government has regularly criticised the political stalemate in the EU accession negotiations,[473] which indicates their perception of the lack of willingness on the part of Brussels to fulfil its "promises".[474]

Consequently, some of the positive accomplishments achieved by the incumbent Turkish government in the early years of its ascent to power have since then been reversed, put on hold or not fulfilled to the full extend. Especially the introduction of civilian control over the military establishment, which was widely seen as the architect of the consecutive military *coup d'états* in Turkey in 1960, 1971, 1980 and 1997 (in order to restore *"democratic rule"*) and the culprit of systematic violation of human rights via the military courts, was one of the several factors that served as a gateway to the opening of accession negotiations in the early 2000's.[475] However, the latest progress reports by the EC indicate that, there are persistent concerns about the legitimacy of the trials over military personal arraigned for coup allegations,[476] other human rights violations and continuous drift of

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469 Interview with a senior officer from the EEAS in charge of the EU-Turkey bilateral relations, 21/04/2015, Brussels.

470 *Turkey 2012 Progress Report, SWD(2012) 336*, p. 5.

471 Winrow, 'Problems and Prospects for the Fourth Corridor: The Positions and Role of Turkey in Gas Transit to Europe', p. 7.

472 Ahmet Davutoğlu, The Cairo Review Interview: Strategic Thinking, 2011, p. 11; 'Davutoğlu: Turkey a Crossroads of Global Energy Transportation', *TODAY'S ZAMAN*, 10 August 2009 <http://www.todayszaman.com//news-183531-davutoglu-turkey-a-crossroads-of-global-energy-transportation.html> [accessed 14 August 2013].

473 *Turkey 2012 Progress Report, SWD(2012) 336*, p. 10.

474 I use the word "promise" in quotation marks, for it is my contention that the commitment on the part of the EU to grant Turkey membership prospects was at best ambiguous.

475 Schimmelfennig, Engert and Knobel, 'The Impact of EU Political Conditionality', pp. 41, 42; see also, Owen Parker, '"Cosmopolitan Europe" and the EU–Turkey Question: The Politics of a "common Destiny"', *Journal of European Public Policy*, 16.7 (2009), 1085–1101.

476 *Turkey 2012 Progress Report, SWD(2012) 336*, p. 7.

otherwise secular state into a religious polity, leading to the apprehensions that the *liberator* itself started behaving in an authoritarian fashion.

In a separate and more recent development, Turkish police attacked the environmental demonstrators in Istanbul's Gezi Park with an unmatched force. Turkey's then EU Minister Egemen Baris called the subsequent Taksim protesters *"terrorists"*,[477] while further complicating the EU-Turkey accession negotiations.[478]

Furthermore, the current Turkish government showed the same irreconcilable attitude towards the resolution of almost half a century old Cyprus problem and by extension to the territorial integrity of an EU member state, i.e. the Republic of Cyprus. During the Cyprus Presidency of the Council of the EU during the second half of 2012, Turkey froze its relations with this institution. The European Council called on to the Turkish government to show *"full respect for the role of the Presidency of the Council, which is a fundamental institutional feature of the EU provided for in the Treaty"* and expressed its concerns about the antagonistic statements made by the former.[479] Considering the fact that accession to the EU requires unanimous endorsement by all the EU member states, such an antagonistic rhetoric on the part of the Turkish government is highly unlikely to brighten Turkey's membership prospects in the near future.

Moreover, one also has to look into the essence of Turkey's EU membership "promise" when analysing the progress on the rule adoption, *inter alia*, in natural gas sector. To start with, EU-Turkey accession negotiations were initiated only following the European Council decision in December 2004, which some theorists attributed to the EU's own *"rhetorical entrapment"*.[480] Some experts argue that, Turkey's consistent reforms, among others, in broadening domestic political freedoms, abolishing death penalty, ensuring *civilianisation of politics*, as well as cultural rights for Turkey's Kurdish minority,[481] the EU was entrapped in its own "promise" previously made in return to these reforms.[482]

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[477] Marc Champion, 'Germany's EU Block Hurts Turkey's Protesters', *Bloomberg*, 23 June 2013 <http://www.bloomberg.com/news/2013-06-23/germany-s-eu-block-hurts-turkey-s-protesters.html> [accessed 30 June 2013].

[478] Andrew Rettman, 'Police Brutality Threatens Restart of EU-Turkey Talks', *EU Observer*, 7 June 2013 <http://euobserver.com/enlargement/120417> [accessed 3 July 2013].

[479] *Turkey 2012 Progress Report, SWD(2012) 336*, p. 5.

[480] Neill Nugent, 'The EU's Response to Turkey's Membership Application: Not Just a Weighing of Costs and Benefits', *Journal of European Integration*, 29.4 (2007), 481–502; Alexander Burgin, 'Cosmopolitan Entrapment: The Failed Strategies to Reverse Turkey's EU Membership Eligibility', *Perspectives: Review of International Affairs*, 18.2 (2010), 33–56; Frank Schimmelfennig, 'The Community Trap: Liberal Norms, Rhetorical Action, and the Eastern Enlargement of the European Union', *International Organization*, 55.01 (2001), 47–80.

[481] For a comprehensive review, see e.g. Ergun Ozbudun, 'Democratization Reforms in Turkey, 1993–2004', *Turkish Studies*, 8.2 (2007), 179–96.

[482] European European Council, *Copenhagen European Council, Presidency Conclusions* (Brussels, 2002), p. 5.

Following the EC's positive political conditionality report on Turkey,[483] the European Council had no option but to open accession negotiations with Turkey while recognising its future membership status.

In light of this, however, others argued that, *"rhetorical entrapment"* of the EU did not actually take place. In fact, although the 2004 European Council decision officially calls *accession* a common objective for both the EU and Turkey, its language is so ambiguous that it leaves a leeway for *short-of-full-membership* interpretations, in addition to a special membership criterion for Turkey, namely, the possibility of indefinite ban on free movement of labour.[484] In itself, the occurrence or non-occurrence of *"rhetorical entrapment"* with regard to Turkey's EU accession process is not of primary interest here. What is important though, is the official recognition that accession *"negotiations are an open-ended process, the outcome of which cannot be guaranteed beforehand"*, which is codified into the 2004 European Council decision.[485] That is to say, although officially speaking, the EU has "promised" Turkey membership prospect at some point in the future, recognition of open-ended negotiations encourages *closed-doors politics* (by certain member states) towards Turkey. This feeds into the suspicions that, in itself even full compliance with the EU's political and *acquis* conditionality may not guarantee the ultimate reward - membership.

In this regard, although the size of the final reward is in principle substantial, the open-endedness of the accession process undermines the speed of attainment thereof. In addition to the stalled accession negotiations since 2012, in his "*Political Guidelines"* the (then candidate and currently) president of the EU executive indicated that, no new members would be joining the EU during the mandate of the 2014-2019 Commission.[486] This later followed with the Commission downsizing its Directorate-General on Enlargement and Neighbourhood Policy and even replacing *"enlargement"* with *"enlargement negotiations"* in the DG's name in order to comply with Juncker's Political Guidelines mentioned-above. Against the backdrop of already reduced enthusiasm for European aspirations in Turkey, such factors diminish the prospect of imminent membership and with it the incentives for Turkey to approximate its domestic legislation and policies with that of the EU *acquis* and policy.

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[483] *Recommendation of the European Commission on Turkey's Progress towards Accession* (Brussels: European Commission, 2004).

[484] Beken Saatcioglu, 'The EU's "Rhetorical Entrapment" in Enlargement Reconsidered: Why Hasn't It Worked for Turkey?', *Insight Turkey*, 14.3 (2012), 159–76 (p. 166).

[485] *Brussels European Council, Presidency Conclusions* (Brussels, 2004), p. 7.

[486] Jean-Claude Juncker, 'A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change, Political Guidelines for the next European Commission', 2014, p. 20.

2.2. Credibility of conditionality

As argued above, EU's commitment to the eventual Turkish membership is at best shaky as evidenced in the opposition from important political actors in EU member states.[487] This has not only slowed down the reforms process by the government, but also undermined the popular trust in the reliability of EU promises. Notably, popular support for EU membership in Turkey has fallen from over 70% when talks began in 2005 to as low as 33% in 2013.[488]

This cooling of relations since 2005 is reflected not only in the limited level of harmonisation of Turkish legislation and policies with the EU *acquis*, but also in the rollback of the institutional capabilities of the relevant Turkish state institutions to foster the harmonisation process. In its recent progress report, the European Commission complained that, EU Harmonisation Committee of the Turkish Parliament *"remains an auxiliary committee with a limited mandate and ability to scrutinise legislation."*[489] The Committee was set up when the accession negotiations were proceeding at a relatively normal speed. Every piece of legislation that was submitted to the Turkish Parliament had to go through this committee and its role was to analyse whether there was anything in each piece of legislation that might have impact on the accession process. The compatibility check was actually a primary task of the relevant bureaucrats at the Ministry of the EU Affairs and in other line ministries in Turkey. However, the EU Harmonisation Committee was intended to provide a higher profile political scrutiny over the legislative process in the country by ringing *"the alarm bells"* to ensure that nothing impinges upon the EU accession process. However, as the accession negotiations began to slacken towards the end of the first decade of the current century, there was less motivation to carry out this high profile exercise and the involvement of the mentioned parliamentary committee to the legislative process in Turkey has been rolled back.[490]

To sum it up, although the EU membership still seems to be a priority political orientation for the Turkish government, lack of overall progress in accession negotiations was at best insignificant during the past decade. Additionally, discrepancies of opinion in the European capitals on Turkey's cultural and geographical relevance to the EU has largely discouraged the enactment of necessary reforms in full scale.

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[487] Ian Traynor, 'In 1683 Turkey Was the Invader. In 2004 Much of Europe Still Sees It That Way', *The Guardian*, 22 September 2004 <http://www.guardian.co.uk/world/2004/sep/22/eu.turkey> [accessed 24 June 2013].

[488] 'A Tiny Thaw?', *The Economist*, 23 February 2013 <http://www.economist.com/news/europe/21572244-many-turks-have-given-up-progress-towards-eu-inches-forward-tiny-thaw> [accessed 14 August 2013].

[489] *Turkey 2012 Progress Report, SWD(2012) 336*, p. 9.

[490] Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.

In this regard, although the threat of withholding the reward from Turkey - *a membership carrot* - is great, the credibility membership promises remains at best uncertain in the foreseeable future, too. Therefore, in addition to the speed of final reward, the lack of credibility of future membership constitutes a major factor leading to the failure of Europeanisation of Turkey and by extension its energy sector.

Nonetheless, in itself these factors cannot ***directly*** mediate between the Turkish government's preferences and political decisions regarding the adoption or rejection of the EU *acquis* in natural gas sector in specific. This becomes especially evident given the considerable progress that Turkey has achieved in harmonising its electricity, renewables, security of energy supply (i.e. oil, coal and gas stocks) and energy efficiency legislation with the relevant EU *acquis*.[491]

Following the opening of the accession negotiations, the Turkish Parliament passed the *Law Concerning the Use of Renewable Energy Resources for the Generation of Electrical Energy No. 5346,* which came into force 18 May 2005. This law established the basic framework for the promotion and use of renewable energy sources (RES) in Turkey and was modelled under the German Renewables Energy Act, aiming at expanding *"the utilisation of renewable energy resources".*[492] It served as a stepping-stone on the way of alignment and implementation of the relevant EU legislation.

The *Energy Efficiency law No. 5627,* which is envisaged to comply with the EU Directive 2006/32/EC and Directive 2002/91/EC, additionally, was adopted in 2007 and *"covers the principles and procedures for promoting energy efficiency so as to reduce the burden on energy cost on the economy and on the environment."*[493] In addition to rule adoption at the formal level, official reports indicate palpable progress in terms of practical implementation of these legislative acts. The Energy Community in its latest progress report indicated that, Turkey's electricity sector is on the track to transitioning *"from a largely state owned monopoly into a liberalised unbundled market with private sector participation."*[494] Unlike the natural gas network owner and operator BOTAS, Turkish Electricity Transmission Company (TEIAŞ) has been ownership unbundled and operates the relevant transmission lines on a regulated third party access basis in line with the EU *acquis*.

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[491] Interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels.

[492] *Study on the Implementation of the New EU Renewables Directive in the Energy Community* (Energy Community Secretariat, 2010), pp. 265–266.

[493] *Study on the Implementation of the New EU Renewables Directive in the Energy Community*, p. 266.

[494] *Study on the Implementation of the New EU Renewables Directive in the Energy Community*, p. 268.

Furthermore, following the EU practice, both *transmission and distribution operators are required to give priority to renewable power transmission.*[495] Similar overall progress in electricity sector and energy efficiency has also been consistently indicated in the European Commission's progress report on Turkey.[496]

In accounting for this discrepancy between the progress in natural gas and electricity (renewables, efficiency, etc.) sectors, I will below argue that, in the absence of the credible reward in the *foreseeable* future, *net domestic costs* are the ***direct*** causes behind Turkish government's political decision to not to adopt EU *acquis* in natural gas sector.

2.3. Net domestic costs and ensuring Turkey's natural gas security and transit role

Turkey has been an important player in regional energy diplomacy ever since the start of pipeline transportation of energy (both oil and gas) from the Caspian Basin and the Middle East over the last two decades. In this regard, although energy entails both economic and political implications for Turkey's domestic and foreign policy, the country has yet to develop a uniform state *energy security strategy*. However, under its formal remits for determining the state energy policy, the Turkish Ministry of Energy and Natural Resources has developed two successive *Strategic Plans* in the past couple of years, covering the periods of 2010-2014 and 2015-2019 (*see* **Fig. 9** and **Fig. 10**). These plans list the major goals and objectives in ensuring domestic energy security.

Fig. 9: Strategic Plan 2010-2014 | Turkish Ministry of Energy and Natural Resources of Turkey, 2010

Strategic Theme 1: Energy Supply Security

- **Aim 1** - Providing Diversity in Resources by Giving Priority to the Domestic Resources
- **Aim 2** - Increasing the share of the renewable energy resources within the energy supply
- **Aim 3** - Increasing Energy Efficiency
- **Aim 4** - Making the free market conditions operate fully and providing for the improvement of the investment environment (especially electricity)
- **Aim 5** - Providing the diversity of resources in the are of oil and natural gas and taking the measures for reducing the risks due to importation

Strategic Theme 2: Regional & global influence of Turkey in the area of energy

- **Aim 6** - Turning Turkey into an energy hub and terminal by using our geo-strategic position effectively within the framework of the regional cooperation processes

[495] *Study on the Implementation of the New EU Renewables Directive in the Energy Community*, p. 269.

[496] *Turkey 2012 Progress Report, SWD(2012) 336*, pp. 60–61; *Turkey 2013 Progress Report, SWD(2013) 417*, p. 35. Furthermore, the stark difference in progress between natural gas and electricity, renewables and energy efficiency was also pointed out by the relevant official from the EC/DG Enlargement Negotiations and Neighbourhood Policy during one of the elite interviews, 26/05/2015, Brussels.

Fig. 10: Strategic Plan 2015-2019 | Turkish Ministry of Energy and Natural Resources of Turkey, 2015[497]

STRATEGIC THEME : ENERGY SUPPLY SECURITY

Goal : Strong and reliable Energy Infrastructure

- Ensuring natural gas storage capacity to be able to meet 20% of the annual consumption in the long-term
- Constructing and operating electricity and natural gas transmission systems according to (n-1) criteria, with no regional bottlenecks

Goal : Optimum Resource Diversity

- Increased electricity generation from domestic coal
- Inclusion of nuclear energy into electricity generation portfolio
- **Diversification of import countries and routes by adding new source countries and routes into natural gas import portfolio**
- Increased domestic oil and natural gas exploration and production activities
- **Reducing the share of natural gas in total electricity generation to 38%**
- Expansion of LPG and dumped LNG use in the regions

Goal : Effective demand management

- Transition to liberal market in the natural gas and the price shall be formed within a supply-demand balance

STRATEGIC THEME – REGIONAL & INTERNATIONAL EFFECTIVENESS

Goal : Turkey integrated with regional Energy markets

- By making ENTSO-E connection permanent, Turkey's integration with European electricity markets
- Increasing international electricity interconnection capacity by two-fold until the end of 2019
- Participation in the regional electricity markets through market coupling and undertaking duties in the organisations regarding the functioning of regional markets
- **By implementing new transit pipeline projects, strengthening the role of Turkey as a natural gas corridor**

Goal : A powerful Actor in International Arena

- **Creating new international oil, gas, coal and raw materials sources by partnering stong national companies with the international companies having foreign investments for exploration**
- Enhancing the effectiveness of Turkey in international energy institutions (e.g. IEA, IRENA)
- Establishment of representation offices of the Ministry of Energy and Natural Resources in USA, Russia, Azerbaijan, Iraq, France, in order to engage in energy diplomacy

[497] The contents of both Strategic Plans have been condensed for the purpose of saving space, as well as with the intention of keeping the focus on natural gas sector in specific. In doing so, the order of prioritisation provided by the Ministry was kept intact. It is also worth mentioning that, both plans also list environmental protection and technological innovations among its energy security priorities, although they are less relevant for the purpose of this PhD.

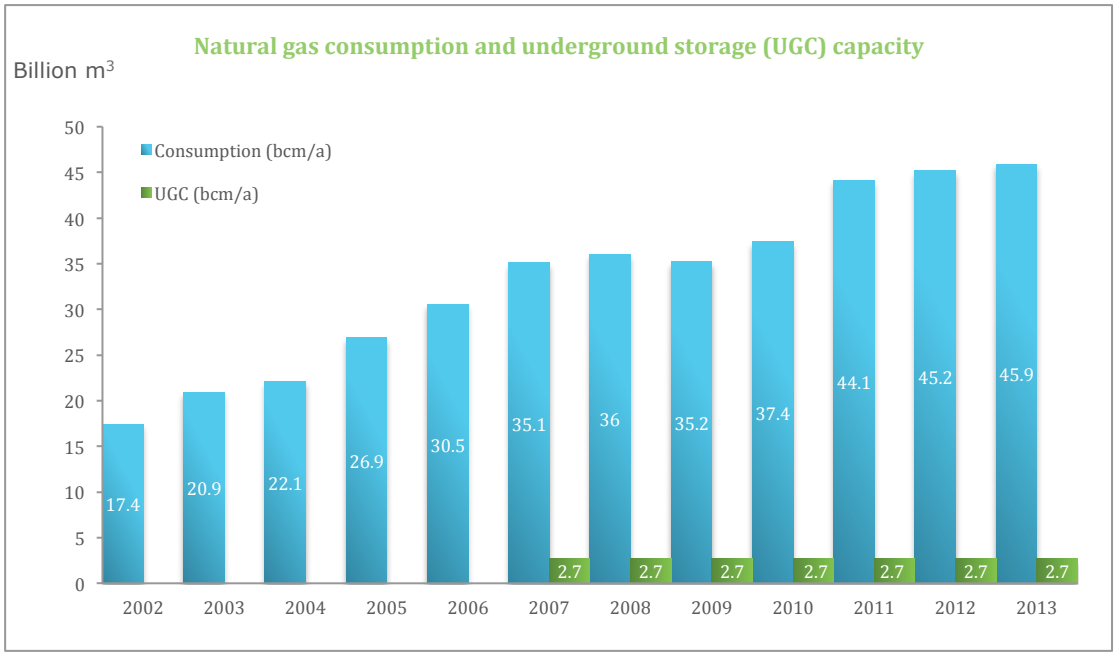
Based on these two Strategic Plans, Turkey's (officially available) energy security strategy can be compiled into two priorities:[498]

I. Ensuring energy (gas) supply security for the domestic market,

II. Achieving global/regional influence of Turkey in energy security by turning the country into an energy *hub*.

In this context, Turkey is in need of supplying domestic market with enough gas volumes in order to avoid shortages in energy provision to households, power generation plants, as well as industrial complex, especially chemical industry which uses gas (also) as feedstock. In the past decade Turkish natural gas demand has risen by almost 230% (*see* **Fig. 11**), both due to the positive economic growth and the gasification of the previously secluded provinces.[499]

Fig. 11: Turkish natural gas consumption and underground storage capacity | MENR, 2014[500]



According to projections, the demand for gas is set to rise to 70 bcm/a by 2030 due to its relative price competitiveness, positive economic growth and increasing share of natural gas in electricity generation in Turkey.[501] Given that 98.5% of Turkey's gas demand is procured from foreign sources, this will likely increase the vulnerability of the country to

[498] Both of these priorities were also highlighted during the interviews with the former Turkish EU Ambassador Selim Kuneralp and the current senior Turkish diplomat at Turkey's EU Mission, 10/04/2015, Brussels.

[499] *Strategic Plan (2015-2019)* (Ministry of Energy and Natural Resources of the Republic of Turkey, 2015), p. 28; *Deloitte Report: Turkey's Natural Gas Market Expectations and Developments 2012*, p. 15.

[500] *Strategic Plan (2015-2019)*, p. 27.

[501] Rzayeva, *Natural Gas in the Turkish Domestic Energy Market: Policies and Challenges*, pp. 7–10.

external supply shocks. Against this backdrop, although the Turkish Ministry of Energy intends to decrease the share of gas in electricity generation, the Turkish national regulatory authority has been steadily increasing licenses issued to the gas-based private power generation companies.[502]

Hence, although it is difficult to project the composition of Turkey's energy mix in the coming decades, the share of natural gas is set to increase both in absolute and relative terms. Given that virtually all of this gas will come from external sources, this has affected and will further determine the policy choices undertaken by the Turkish government in natural gas sector. Thus, in analysing the root-causes of the failure of the Europeanisation of Turkey's natural gas sector, I will below explore different factors, which are (also) conditioned by the above-mentioned energy security priorities of the Turkish government.

2.3.1. Net adoption costs

To start with, Turkey's gas import portfolio is fairly diversified (at least, in contrast with the majority of the Eastern European countries) with gas being supplied by Russia, Azerbaijan, Iran and spot LNG from Algeria. Despite this, the security of supply cannot always be guaranteed due to the steep seasonal gas demand and supply fluctuations, as well as the technical and production problems faced by the supplier countries. For example, in early 2012 Turkey's gas imports from Iran and Azerbaijan experienced sharp decline following almost simultaneous technical difficulties by both counties. Facing the domestic supply shortages due to the cold spell related domestic demand hike, Turkey without warning stopped its gas re-exports to Greece via the cross-border interconnection capacity, which was commissioned in 2007.[503]

In the bigger picture, this gas cut-off to Greece was not driven by any (geo)political considerations on the part of Turkey, but was rather conditioned with the necessity of ensuring domestic supply first. In a liberalised environment governed by the EU rules, shortage of energy supply would have triggered price hikes and equivalent reduction of consumer demand in the gas market. This would have subsequently lead to a new supply and demand equilibrium. Therefore, from the EU perspective it would be more efficient for Turkey to allow the market forces to determine the supply and demand balance in the country. However, from a Turkish perspective this balance would have been achieved at the expense of the energy prices offered to the Turkish domestic consumers. Therefore, in

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[502] Rzayeva, *Natural Gas in the Turkish Domestic Energy Market: Policies and Challenges*, p. 9.

[503] 'Turkey Increases Gas Exports to Greece', *Turkish News*, 7 February 2012 <http://www.turkishnews.com/en/content/2012/02/07/turkey-increases-gas-exports-to-greece/> [accessed 28 March 2012].

line with its strategic plan, the Turkish government prioritised domestic supply over the external commitments and restarted gas exports to Greece only after meeting the natural gas demand of the Turkish households and industry, as was explained by the then Turkish Energy Minister Taner Yildiz.[504]

From a regulatory point of view, this was rendered possible due to the state control over the domestic transmission lines, as well as gas export/transit activities. In fact, under the Turkish NGML, public and private companies are required to acquire export licenses from the Turkish Regulatory Authority in order to be able to engage in gas export activity in Turkey. Export licenses, on the other hand, are granted only if the *"export process will not intervene in the operation of the system or the satisfaction of the natural gas demand of the country".*[505]

Although this and other incidents may be considered as isolated or emergency cases that can still be addressed with emergency action plans under the free market principles, the rationale of Turkey's preference to control the transit and gas export activities becomes all the more evident under normal market conditions. To start with, due to its strategic geographical location, Turkey is surrounded with the largest gas reserves in the world. Accordingly, it acts as the transit bridge between these reserves and 500 million strong consumer market to the West. Acknowledging this fact, both Strategic Plans of the Turkish government highlight the necessity of ensuring the diversity of supply sources and routes in order to ensure energy supply security of the Turkish consumers.[506] However, the strategy pursued by Turkey was not only aimed at importing ample and diverse gas volumes to meet surging domestic demand, but also getting the best price deals from different suppliers. To this end, the Turkish authorities have in the past insisted that, due to its vital role in the establishment of the Southern Gas Corridor, Turkey must be entitled to purchase domestic gas under discounted prices compared to the consumers in Europe.[507] Additionally, Turkish officials have been arguing for the right to lift-off 15% of the gas to be transported across its territory via Nabucco (or any other line) at *"reasonable prices"* as transit privilege.[508]

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504 'Turkey Sends Gas to Greece as EU Slams Gov't in Athens'.

505 'Natural Gas Market Law, No. 4646', Article 4.

506 *Strategic Plan (2010-2014)* (Ministry of Energy and Natural Resources of the Republic of Turkey, 2010), pp. 12–13; *Strategic Plan (2015-2019)*, p. 36.

507 Interview with a senior SOCAR official, 29/06/2015, Brussels.

508 Erdogdu, 'Bypassing Russia: Nabucco Project and Its Implications for the European Gas Security', p. 2942; see also, Saltuk Duzyol, 'NABUCCO Projesi ve Türkiye (NABUCCO Project and Turkey)' (Presentation by BOTAS General Manager at the Middle East Technical University, Turkey, 2009) <http://www.odtumd.org.tr/etkinlik/2009/03/NABUCCO_projesi/NABUCCO_Sunumu_ODTU_S_Duzyol_28_03_09.pdf> [accessed 12 August 2013].

In practice, this policy line can be argued to have worked well for the Turkish government. For example, following the lengthy negotiations on the transit passage of Azeri gas to the EU, the Turkish authorities managed to secure discounted gas purchase prices from Azerbaijan, which is constantly pegged to the 85% value of the Russian gas sale prices to Turkey.[509] Additionally, under the intergovernmental agreement on the standalone TANAP pipeline, Turkey managed to commit Azeri authorities to offer any future available export volumes from Azerbaijan (in addition to SH II volumes) to the Turkish market first and only after to the EU consumers.[510]

By using its transit status as a bargaining chip Turkey has, thus, managed to secure favourable deals, which will contribute to its energy security, as well as economic growth. In this regard, the ability of Turkey to exercise sovereignty over its territory in order to exact benefits from (energy) goods transiting its territory can be considered as a *resource* that the government widely relies on in promoting domestic interests. This *resource* would have to be dispensed with if Turkey was to apply the EU law. Under EU legislation, freedom of access to transmission/transit pipelines must be separate from the gas supply activities in the market. This is to be achieved by regulating the access to pipeline capacity based on pre-published tariffs and market-based capacity allocation mechanisms, such as *auctions*. Shippers/suppliers who want to acquire pipeline capacity will have to do so under equal conditions, regardless of whether their gas will be destined for the domestic Turkish market or will be *transiting* the country on way to third-country markets. In other word, under EU law, the notion of *gas transit* itself disappears, as there is no more difference between *domestic transportation* and *transit* activities (which is why, EU *acquis* refers to all gas transportation activities via high-pressure pipelines as *transmission* regardless of destination, origin or ownership).

Similarly, if Turkey was to apply EU law domestically, it would be formally obliged to ensure equal access to its transmission/transit pipelines, without being able to secure a certain share of the transit gas at discounted prices for the domestic consumption.[511] This would create considerable domestic costs for the government, especially considering the fact that, Turkey is the only OECD Europe country, which will experience significant gas demand increases in the coming decades. As such, access to ample and cheap energy will have a direct effect on the continued growth of the national economy, which unlike the EU economy has been experiencing stable GDP growth - 4.7% on average in the past

[509] Interview with a senior SOCAR official, 29/06/2015, Brussels.

[510] Interview with a senior SOCAR official, 29/06/2015, Brussels.

[511] This was highlighted during the interview with an official from the EC/DG Neighbourhood Policy and Enlargement Negotiations, 26/05/2015, Brussels. For a similar point of view, see also, Winrow, 'Problems and Prospects for the Fourth Corridor: The Positions and Role of Turkey in Gas Transit to Europe', p. 20.

decade.[512] By being an important East-West energy bridge, Turkish government (and BOTAS) is acting as a partially "*monopsonic*" entity to negotiate its gas deals with the neighbouring producers. That is to say, under limited liberalisation of the domestic market, BOTAS remains the single biggest buyer and re-seller of natural gas in Turkey. Dominant status in the domestic market allows BOTAS and by extension the state, to negotiate the best gas import deals among the variety of external supply options, consequently, driving down the prices of imported natural gas. Therefore, although the market is nominally liberalised, it is no surprise that negotiations on gas supply have always remained high in the agenda of the Turkish political establishment in its bilateral and multilateral relations with the relevant supplier countries.[513]

Secondly, certain energy projects in Turkey can be realised only if the interests of the project promoters are taken into account. To put this into perspective, the Azerbaijani government has repeatedly declared that it will build TANAP in Turkey, which will initially carry 16 bcm/a gas, 6 bcm/a of which will be destined for the Turkish domestic market, only with the condition that SOCAR (State Oil Company of Azerbaijan Republic) is allowed to hold the majority of stakes in (hereby, control over) the pipeline.[514] However, the very design of EU energy *acquis* is envisioned to curtail the suppliers' (in this case SOCAR and other upstream players') control over the transmission lines, so that the latter could not discriminate against other suppliers from having equal and fair access to the same pipelines. In this regard, if the EU *acquis* were to be fully applied in Turkey prohibiting SOCAR to acquire the control over TANAP, Azeri company would be dis-incentivised from building the pipeline in the first place. Consequently, if TANAP were not to be built, the consortium operating the Shah-Deniz gas field in Azerbaijan would be unlikely to invest $22+ bln in the second phase of the development of the giant gas field and hereby no additional volumes of gas would be available for export to the EU and Turkey.

Obviously, EU law also envisages derogations from certain provisions, such as *unbundling*, *third party access* or *regulated tariffs*, which could be applied to TANAP, too.[515] Nonetheless, the implementation of the EU legislation in Turkey would *in itself* create high-risk environment for the upstream producers, who also own and operate the SCPx and TANAP. The payback period in these kinds of projects is long, usually around 25-30 years. Therefore, in the presence of regulatory risks in Turkey, which could fully or

512 *Economic Outlook No 96, OECD Annual Projections*, November 2014.

513 Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.

514 'SOCAR President: We Will Keep Operatorship of TANAP', *Natural Gas Europe*, 4 April 2012 <http://www.naturalgaseurope.com/socar-will-keep-tanap-operatorship-5729> [accessed 7 April 2012].

515 Interview with an EC/DG Energy official, as well as Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

partially impinge upon their ownership, control and operatorship of the high-cost transmission/transit pipelines, the SGC stakeholders would be unlikely to invest in TANAP (and other parts of this "mega-project"). Consequently, by diminishing or delaying the prospects of new Azeri gas supplies for Turkey, the Europeanisation of the Turkish natural gas sector could potentially entail security of supply implications for the country's domestic market. This, in turn, would undermine Turkey's attempts to decrease its dependence on Russian gas, which makes up the bulk of its domestic consumption and turn it into Russia's *"energy satellite"*.[516]

Thirdly, in addition to its desire to exact transit benefits from gas traversing its territory, the Turkish Strategic Plan on energy envisages turning the country into an *energy hub.*[517] In this regard, it has been no secret for some time that, Turkey wants to establish itself not only as a merely transit country, but also as a natural gas hub where it will be able to play the role of a *middleman* between the Caspian and Middle Eastern gas producers and the EU consumers.[518] In this vein, natural gas hub does not simply imply a physical intersection of different pipelines in a particular territory (although it is a vital component thereof). As the renowned expert in Caspian energy politics, Vladimir Socor clarifies, *"A hub country buys another country's gas, stores it and re-sells it as its own gas to third countries at a higher price. A transit country, however, provides transit service through pipelines on its territory for an agreed (cost-based) fee, enabling the producer country to enter into direct commercial relations with the customers for its gas".*[519] In this regard, if Turkey manages to buy gas in cheap at its Eastern border and re-exports it to the EU at a dearer price, then it will bring additional economic benefits for the Turkish state-controlled energy companies. The application of the EU rules in Turkey, on the other hand, would not allow Turkey to perform the role of a single middleman, for the supply and trading activities will have to be liberalised and carried out not only by BOTAS but also by private entities, hence providing limited revenues for the state.

2.3.2. Europeanisation and opportunity costs

Europeanisation of Turkey will likely entail potential costs not only in relation to the energy and economic security of Turkey, but also with regard to its domestically

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[516] Mert Bilgin, 'Energy and Turkey's Foreign Policy: State Strategy, Regional Cooperation and Private Sector Involvement', *Turkish Policy Quarterly*, 2010, 81–92 (pp. 88, 91).

[517] *Strategic Plan (2010-2014)*, pp. 29, 31; *Strategic Plan (2015-2019)*, pp. 23, 73.

[518] See e.g. Shaffer, 'Caspian Energy Phase II: Beyond 2005', p. 7214.

[519] Vladimir Socor, 'Wikileaks Perturb US-Azerbaijan Relations (Part One)', *Euroasia Daily Monitor*, 7.217 (2010) <http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=37249> [accessed 14 March 2012].

constrained capacity to pursue international (geo)political strategies. These potential opportunity costs can be defined, firstly, in the context of Turkey's EU membership bid and secondly, in the context of Turkey's new (geo)political strategy in the extended Middle East region.

EU-Turkey Accession negotiations

Implementation of the EU energy *acquis* by Turkey has long been leveraged by the latter in order accelerate overall progress in the EU-Turkey accession negotiations. Existence of massive energy reserves and consumer markets in Turkey's neighbourhood makes the Turkish energy corridor a powerful tool for the country's EU membership strategy. The sheer statistical difference between natural gas consumption in the EU (17% of the global overall) and the concentration 47% of world's recoverable gas reserves in the Caspian Basin and the Middle East is staggering. This allows one to reasonably expect that, whatever the futures holds for the realisation of the Southern Gas Corridor, Turkey will always aspire to play a key role in it and take advantage of such a strategic position in pursuing its national interests, for which the ability to exercise influence over the pipelines traversing its territory is paramount.

In this regard, as was already mentioned above, the energy chapter of the accession negotiations is currently blocked by Cyprus due to a political dispute between the two countries. Despite this, the EU has long been pushing Turkey to join the Energy Community Treaty, the leitmotif of which is rather the export of the EU energy legislation and policies into non-EU countries. So far Turkey has duly ignored the call and satisfied itself only with an observer status in the EnCT.[520]

This policy choice by the Turkish government is in fact very rational. Europeanisation of the Turkish energy system through the membership in the EnCT (or on a voluntary basis) would ultimately adjust Turkey's energy policy choices under the EU preferences. However, this would not result in any tangible progress in the EU accession process, because the energy chapter remains blocked for political reasons. Thus, since the eventual EU membership remains one of the strategic goals of the Turkish government, then the strong influence of the Turkish government in the development of the SGC could be used as a bargaining chip to force the EU capitals to be more accommodating to Turkey's European aspirations. In this context, although there were no formal links between Turkey's ratification of the Nabucco[521] intergovernmental agreement in 2009 and the

[520] Interviews with an official from the EEAS, 21/04/2015, Brussels and with Selim Kuneralp, 10/04/2015, Brussels.

[521] Nabucco was intended to traverse Turkish territory while being in compliance with the EU *acquis*.

country's EU accession process, Ankara was eager to capitalise on its vital role in the realisation of Nabucco pipeline and force the EU to move ahead with opening of the energy chapter. The former Turkish ambassador to the EU Selim Kuneralp had argued that, EU natural gas *acquis* and Nabucco's legal framework were based on common principles and therefore the unblocking and opening of *"energy chapter in the accession negotiations [...] would accelerate the adoption of EU legislation in the energy sector [in Turkey] and thus Nabucco".*[522] Hence, in the context of EU accession negotiations, the (non)application of the EU natural gas legislation in Turkey remains a wild card in Turkish government's foreign policy arsenal. This allows the latter to leverage it against the EU's energy diversification strategy in order to achieve tangible progress in the accession process. Therefore, it was no surprise that, similar to the European Commission,[523] the UK's EU Minister David Lidington called on for the "all blocks on chapters [... to] be lifted in the shortest time possible and the path for Turkey's EU membership [... to] be smoothed", while recognising Turkey's special role and contribution in the EU's energy security.[524]

Energy – geopolitics nexus

In analysing the adoption of the EU's energy *acquis* and thereby depoliticisation of Turkish energy policy in general, one also has to take into account overall geopolitical ramifications of these developments on the country's recently stepped-up regional strategy. In this regard, on the one hand Turkey's regional energy strategy can be considered as an end in itself (ensuring domestic energy security), which has already been discussed above. On the other hand, it can also be viewed as a geopolitical instrument - as a means to a separate end.

In this vein, following the ascent of the ruling party (AKP) to power in 2012, Ahmet Davutoglu, the then foreign minister, currently prime minister and the architect of Turkey's revamped foreign policy strategy, has introduced a new dimension - *"strategic depth"*[525] to the country's otherwise Westward political orientation. Davutoglu posits that, Turkey's *"multiple regional identities"* enables it to pursue *"an integrated and*

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[522] Jacob Zirm, 'Kuneralp: "Niemand Kümmert Sich Wirklich Um Nabucco' (Kuneralp: "No One Really Cares about Nabucco')"', *DiePresse*, 2009 <http://diepresse.com/home/wirtschaft/eastconomist/450163/Kuneralp_Niemand-kuemmert-sich-wirklich-um-Nabucco> [accessed 1 August 2013].

[523] Arthur Neslen, 'Oettinger Calls for "Europeanisation" of Energy Powers', *EurActiv*, 2012 <http://www.euractiv.com/energy/oettinger-calls-europeanisation-news-510497> [accessed 2 February 2012]; 'EU Should Open Energy Chapter With Turkey: Stefan Fule', *Scoop.it*, 2013 <http://www.scoop.it/t/turkish-agenda/p/4000116640/2013/04/17/eu-should-open-energy-chapter-with-turkey-stefan-fule> [accessed 20 January 2014].

[524] 'EU Urged to Open Energy Chapter', *Hurriyet Daily News*, 27 February 2014 <http://www.hurriyetdailynews.com/eu-urged-to-open-energy-chapter.aspx?pageID=238&nID=62981&NewsCatID=351> [accessed 28 February 2014].

[525] Ahmet Davutoglu, *Stratejik Derinlik* (Küre Yayinlari, 2001) (original in Turkish).

multidimensional foreign policy", which also includes *"a sense of responsibility"* to contribute to regional issues arising from a common history and geography.[526] However, the role he (and by extension the incumbent government) envisions for Turkey is not that of a regional power, but of a *"central power"* where it plays a central role in several regions (the Balkans, the Middle East, Caucasus, Central Asia, Mediterranean, the Gulf and Black Sea) simultaneously.[527]

With this in mind, in terms of regional geopolitics, Turkey's energy strategy is inseparably linked to the political developments in post-invasion Iraq, where the fight for the influence over the country's political orientation is taking place both at domestic and international levels. After the electoral victory in 2010, the then prime minister of Iraq, Nuri Al-Maliki had settled for an *"omnibalancing game"*,[528] which entails complex balancing act on a domestic (between different ethno-religious groups – Sunnis, Shiites and Kurds) and international (between US, Turkey and Iran) levels.[529] At the domestic level, Kurds and Sunnis were marginalised, while Shiite-Arabs were promoted under the Al-Maliki's Arab-centric government.[530] At international level, on the other hand, such a Shiite dominance of Iraq had pleased Iran, while at the same time ensuring a friendly environment for the US business and allowing limited military presence on Iraqi soil, while sustaining a relatively independent international political orientation. With the Sunni elite dominating the government in Ankara, however, such an *"omnibalancing game"* had significant implications on Turkey's Iraq policy.

In this regard, Turkey had not only expressed its annoyance with the Al-Maliki government, which it accused of side-lining Iraqi Sunnis and fanning sectarian strife in the country by promoting Shiites, but also refused to hand back Iraq's fugitive Sunni Vice-President Tariq Al-Hashemi even after the issuing of global alert by the Interpol.[531] This cooling in the Ankara-Baghdad relations was reflected in the decision by the Iraqi cabinet

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526 Ahmet Davutoglu, 'Turkish Foreign Policy and the EU in 2010', *Turkish Policy Quarterly*, 2009, p. 12.

527 loannis N. Grigoriadis, *The Davutoğlu Doctrine and Turkish Foreign Policy* (Hellenic Foundation for European and Foreign Policy, 2010), p. 4.

528 For a conceptual explanation of the term, see e.g. Jason E. Strakes, 'The "Omnibalancing" Proposition and Baghdad's Foreign Policy: Reinterpreting Contemporary Iraq-Iran-US Relations', *Mediterranean Quarterly*, 22.3 (2011), 95–108 (pp. 95–108).

529 Emre Iseri and Oguz Dilek, 'The Nexus Of Turkey's Energy And Foreign Policy With Iraqi Kurdish Oil: The Iranian Connection', *Ortadoğu Analiz*, February 2013, 25–32 (p. 27).

530 Iseri and Oguz Dilek, 'The Nexus Of Turkey's Energy And Foreign Policy With Iraqi Kurdish Oil: The Iranian Connection', p. 27; Michael M. Gunter, 'Arab–Kurdish Relations and the Future of Iraq', *Third World Quarterly*, 32.9 (2011), 1623–35.

531 'Turkey Rejects Iraqi VP Handover', *BBC*, 9 May 2012, section Middle East <http://www.bbc.co.uk/news/world-middle-east-18009408> [accessed 11 August 2013].

to expel the Turkish State Petrol company (TPAO) from Block 9 (oilfield in Baghdad controlled territory), where the latter held a 30 per cent stake.[532]

All this took place against the backdrop of Turkey's new reconciliatory strategy toward the Northern Iraqi Kurdish Regional Government (KRG) and the establishment of *friendly* relationships. This friendly relationship, first of all, was exemplified with the involvement of Turkish state energy companies in the development of KGR's energy reserves. To this end, after TPAO's eviction from Block 9 in Southern Iraq, Turkish government has taken proactive steps in order to boost the state-controlled energy companies' presence in Northern Iraq. Following the cabinet decision of January 2013, the capital of the state Turkish Petroleum International Company (TPIC) was increased from $150 million to $500 million and its ownership was transferred under the Turkish Pipeline Transportation Company (BOTAS). These steps were specifically tailored to increase BOTAS's presence in Iraqi Kurdistan.[533] This indicates a major shift in Turkey's traditional Baghdad-centric Iraqi policy, which was previously geared towards suppressing the political secessionism of Iraqi Kurdish population, in favour of Erbil (the capital city of KGR).[534]

Some attributed this shift to Turkey's overall geopolitical strategy in the Middle East. According to the vice-president of CHP, Turkey's main opposition party, Faruk Lagoglu - the confrontations with Baghdad were the *"result of Erdogan's efforts to establish a Sunni influence zone to counter Tehran's influence on Shi'ite populations in the region".*[535] Thus, one could interpret Turkey's new fraternity with the KGR as a counter-balancing strategy against Baghdad's Shiite-centric government. In this context, Turkish national energy champions play a role of a proxy in Ankara's political engagement with the regional actors, which is mainly driven by Davutoglu's new foreign policy strategy.

Others argue that the dynamics of Turkey's changing regional strategy has a lot to do with its energy security, as much as its cultural-religious identity. In this regard, one Turkish expert argued that given the country's energy supply flaws, Ankara will incur *"opportunity costs [...] if it does not develop relations as much as it could with partners such Russia,*

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532 Ahmed Rasheed, 'Iraq Says Exxon to Quit Oilfield, Ends Turkey TPAO Deal', *Reuters* (Baghdad, 7 November 2012) <http://www.reuters.com/article/2012/11/07/us-iraq-exxon-idUSBRE8A60Y420121107> [accessed 11 August 2013].

533 Orhan Coskun, 'Newly BOTAS-Owned Turkey Oil Firm Seen Boosting Foreign Presence', *Reuters*, 22 January 2013 <http://www.reuters.com/article/2013/01/22/turkey-energy-idUSL6N0AR2KI20130122> [accessed 11 August 2013].

534 Iseri and Oguz Dilek, 'The Nexus Of Turkey's Energy And Foreign Policy With Iraqi Kurdish Oil: The Iranian Connection', pp. 27–28.

535 Ayhan Simsek, 'Turkey-Iraq Row Escalates', *Deutsche Welle*, 14 May 2012 <http://www.dw.de/turkey-iraq-row-escalates/a-15947701> [accessed 8 August 2013].

Azerbaijan, Iran and Iraq".[536] In a similar manner, Turkey's then energy minister Taner Yildiz had protested that, *"it is unreasonable for Turkey to remain aloof from a region on its border while it looks as far as Venezuela to meet its energy needs. Genel Energy, a British Turkish energy company [...] already has extensive oil and gas interests in the region but Turkish state institutions do not".*[537] Similarly, the Turkish Strategic Plan for Energy identifies BOTAS and the relevant departments of the Ministry of Energy and Natural Resources as the responsible bodies for the *"[d]iversification of import countries and routes [...] by adding new source countries and routes to natural gas import portfolio".*[538]

Hence, whether Turkey's regional energy strategy is attuned to yield political dividends from regional actors (*a means to a separate end*) or geared towards contributing to the country's soaring energy demand (*an end in itself*) or, as is perhaps most likely, both, the existence of strong national energy champions seems to be an essential part of it. In this context, the *premature* application of the EU's energy *acquis* in Turkey would likely limit Ankara's influence over regional geopolitics, as the unbundling and full market liberalisation in Turkey in line with the EU *acquis* would financially and technically weaken the national energy champion - BOTAS and its ability to engage in oversees initiatives. In line with such reasoning, the Strategic Plan 2015-2019 in fact calls for the development of strong and experienced *national companies*, which can be involved in projects in the international arena.[539]

Of course, this Eastward engagement does not amount to a compromise in Ankara's Western political aspirations. It would in many respects render Turkey a more attractive partner for the EU and the USA by transforming it into a major power in the world's most energy rich basins.[540] This follows Davutoglu's *bow and arrow analogy* in foreign politics. The analogy follows that, supported by its ideational and strategic geographical location, Turkey is *"an archer and the more it draws the back of the bow through the East, the farther the arrow flies West".*[541] In discussing this central aspect of the incumbent government's foreign strategy a Turkish expert recaps that, *"[...] Turkey's regional activism in the East is viewed as an independent variable as a means to reach the ultimate goal, which is to be*

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536 Mert Bilgin, 'Energy and Turkey's Foreign Policy: State Strategy, Regional Cooperation and Private Sector Involvement', pp. 85–86.

537 Daniel Dombey and Guy Chazan, 'Turkey and Iraq Kurds close to Energy Deal', *Financial Times*, 12 December 2012 <http://www.ft.com/cms/s/0/e8a5bbc8-446f-11e2-932a-00144feabdc0.html#axzz2apfRq4sT> [accessed 2 August 2013].

538 *Strategic Plan (2015-2019)*, p. 39.

539 *Strategic Plan (2015-2019)*, p. 73.

540 Dimitrios Triantaphyllou and Eleni Fotiou, 'The EU and Turkey in Energy Diplomacy', *Insight Turkey*, 2010, 55–62 (p. 56).

541 Burak Bilgehan Ozpek and Yelda Demirag, 'The Davutoğlu Effect in Turkish Foreign Policy: What If the Bowstring Is Broken?', *Iran and the Caucasus*, 16.1 (2012), 117–28 (p. 118).

strongly located in the West. Therefore, Turkey prioritises its relations with the West and sees the activism in the East as leverage to meet this goal."[542]

Thus, restructuring Turkey's energy system under the EU template by delinking energy from high politics would inevitably curtail Turkey's leverage over the political developments in its neighbourhood and leave the country with fewer political instruments than the advantageous geopolitical location would otherwise offer.

2.3.3. Europeanisation and domestic veto players

Major actors in Turkey's energy policy-making are the Ministry of Energy and Natural Resources, Petroleum Pipeline Corporation (BOTAS), Turkish Petroleum Corporation (TPAO) and the Ministry of Foreign Affairs; the latter being especially influential in the foreign policy aspects of energy security. Among these actors, BOTAS has the most to lose from the full application of the EU law in Turkey, as it will cut back BOTAS's (already slowly) diminishing monopoly in domestic market access. On this subject, BOTAS has argued that the company must retain its key position in domestic gas market and act *"as a 'locomotive' behind which private companies could follow."*[543] The former General Manager of the company Saltuk Duzyol had stressed that it was crucial for BOTAS to remain a key player in Turkish natural gas market in order to be able to extract the best deals from other energy companies in the matters of energy transit through Turkish territory.[544]

In this vein, BOTAS defined energy security strategy for Turkey as a pyramid of priorities, which includes supply security, low-cost gas imports and transit & trade revenues (*see* **Fig. 12**). In principle, BOTAS's priorities are incompatible with the EU *acquis*, for they imply both supply and transmission activities being carried out within the same company (i.e. BOTAS), as well as envisages transit benefits for Turkey in the form of low-cost natural gas imports from transiting gas. In this regard, during the initial years of the gas market liberalisation and unbundling process in Turkey, as the former Turkish Ambassador to the EU put it, BOTAS was fighting the *"real Gods' game"* in order to maintain its monopoly position and hold on to its transmission assets.[545] BOTAS's active opposition to the EU legislation was especially salient during the negotiations on the Nabucco intergovernmental agreement, for the company was arguing for an entitlement for transit

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[542] Ozpek and Demirag, 'The Davutoğlu Effect in Turkish Foreign Policy: What If the Bowstring Is Broken?', p. 118.

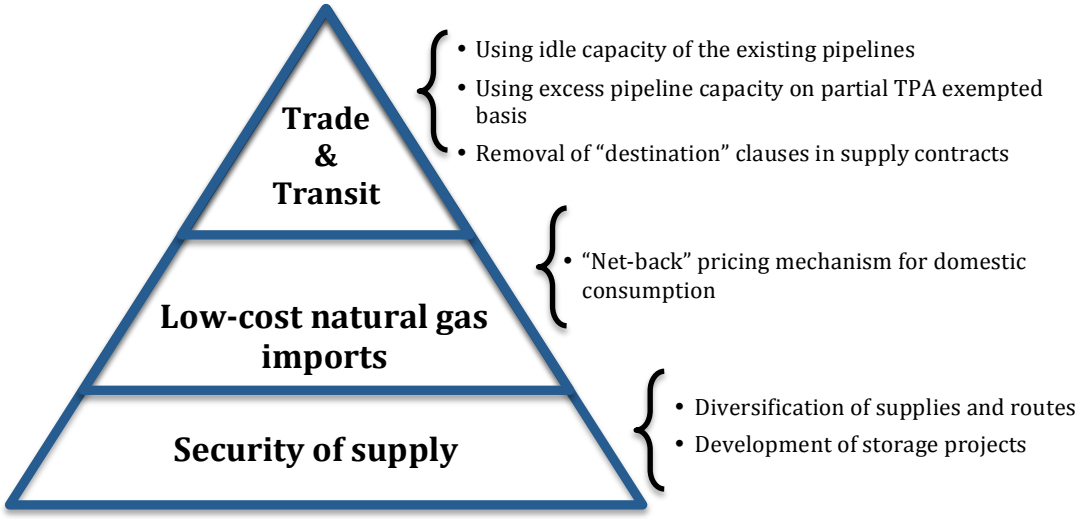
[543] Cited in Winrow, 'Problems and Prospects for the Fourth Corridor: The Positions and Role of Turkey in Gas Transit to Europe', p. 13. This was also indicated during author's interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.

[544] Duzyol, 'NABUCCO Projesi ve Türkiye (NABUCCO Project and Turkey)'.

[545] Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.

benefits in terms of access to 15% of gas volumes to be supplied via Nabucco, which is in direct contradiction with the EU law.

Fig. 12: BOTAS's priority pyramid for Turkish gas sector[546]



Nonetheless, although the company has considerable influence over the transit regime for gas transportation across the country, which was evident during the negotiations on the transit of Azeri gas through Turkey, BOTAS is not granted with formal veto powers as far as the rule adoption in Turkey is concerned. In fact, during the Nabucco IGA negotiations, BOTAS's position was overruled by the Ministry of Foreign Affairs of Turkey. The former Turkish ambassador to the EU explained that, *"if the price of accession to the EU was the demise of BOTAS as it stands at the moment, BOTAS would have to go"*.[547]

Secondly, the Ministry of Energy and Mineral Resources (MENR) holds the main formal powers in determining the course of reforms in Turkey's energy sector. In this capacity, the MENR seems to share similar sentiments with BOTAS and is interested in maintaining the role of state enterprises in energy supply and strengthening their involvement in international energy projects. In improving the country's energy performance, the Turkey's Strategic Plan for energy argues that, MENR will take actions to ensure *"full harmonisation [of the domestic legislation] with the EU Energy Efficiency acquis and especially with the cogeneration regulations will be provided."*[548] In addition, in the latest 2015-2019 Strategic Plan for Energy, MENR illustrates the importance of further liberalisation of Turkey's electricity sector, the necessity of *"the creation of more*

[546] Duzyol, 'NABUCCO Projesi ve Türkiye (NABUCCO Project and Turkey)'.
[547] Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.
[548] *Strategic Plan (2010-2014)*, p. 21.

transparent and liquid markets and for obtaining electricity from cost-advantageous markets" and its permanent integration with the European electricity market.[549]

However, neither plan mentioned, even in passing, the same EU harmonisation vision in natural gas sector. This also signifies the dominant view that, the Ministry is interested in keeping governmental control over the natural gas sector. Quite the opposite, MENR stressed that Turkey must capitalise on its advantageous geographical position in securing domestic energy supply and *"leading a significant role in the transfer of the rich hydrocarbon resources to the growing markets and especially the EU market."*[550]

In support of this view, it is also worth mentioning that, according to Turkish NGML of 2001, BOTAS was banned from concluding any new import contracts until its shares drops under 20% in domestic market. However, the Turkish government has very recently directly violated this legal prescription. According to the agreement signed with Shah Deniz consortium in 2012, BOTAS will purchase 6BCM of gas from the second phase of Shah-Deniz two for domestic supply (without destination clause), as well as hold 30 per cent shares in the new to be built Trans-Anatolian Pipeline (TANAP). These developments have been ratified both by Azerbaijani and Turkish parliaments, although in principle they are incompatible with the Turkish NGML (as well as the EU *acquis* for unbundling reasons).

Thirdly, Turkish Ministry of Foreign Affairs plays a significant role in the EU accession aspects of domestic energy policy-making. In fact, the MFA played a leading and conciliatory role during the negotiations with the European Commission over the Intergovernmental Agreement (IGA) for the NABUCCO pipeline.[551] Furthermore, as it has already been mentioned above, Turkish diplomats have in the past linked the implementation of the EU's energy *acquis* in Turkey to the progress in country's EU accession negotiations and have questioned the expediency of the application of the EU's energy legislation domestically if Brussels is unwilling to open the energy chapter due to a political veto. In this regard, although in the past Turkish MFA had played a conciliatory role to ensure the compliance of the Nabucco IGA with the EU *acquis*, it has less interest to foster the same process with regard to Turkey's domestic legislation, for it does not contribute to the EU accession process.[552]

Last but not least, there is also an indirect link between the domestic political dynamics in

[549] *Strategic Plan (2015-2019)*, p. 74.
[550] *Strategic Plan (2010-2014)*, p. 28.
[551] Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.
[552] Interview with Ambassador Selim Kuneralp, 10/04/2015, Brussels.

Turkey and the failure of *depoliticisation* of the natural gas market in the country. This is especially relevant in relation to the freedom of transit across Turkey in light of the increasing authoritarianism[553] of the ruling party. This is not to suggest that the adoption of the EU rules is contingent upon the level of democracy in a candidate/partner country. The voluntary adoption of the EU electricity market rules, which are based on the same principles as the EU natural gas *acquis*, by the very authoritarian Turkish government is a testimony to the contrary. It is rather to argue that there is a political utility for strong government control over the transit of energy resources across Turkey. The latter provides a leverage for the regime against the political pressures from the EU in relation to its poor governance records. As the adoption of the EU third energy package would deprive the Turkish government of this political instrument, thus, its rejection can be explained also in relation to the internal political dynamics in the country.

Nonetheless, this is not to posit that democratisation of Turkey would automatically lead to the adoption of the EU natural gas market rules. EU rules present but one of the many models available for *organising* natural gas markets; hence, they are not linked to the process of democratisation or the fundamental principle of legitimacy of a democratic society. Indeed, so long as there are no credible progress in the EU accession negotiations, any democratically accountable government in Turkey would find it economically and strategically costly (as argued above) and potentially, unpopular to implement the EU rules in natural gas sector.

Without tangible economic and political benefits, the voluntary implementation of the EU natural gas rules would also make the ruling conservative government seem weak. Ever since the ascend to power in 2001, the popularity of the islamist AKP government in Ankara has largely been based on the strong economic growth that the country has been experiencing. This has helped to raise the living standards in the country, while the islamist "neo-populism" preached by the AKP government resonated with the broad conservative strata of the Turkish society.[554] As note above, strong economic growth in Turkey also spurred strong demand for cheap energy, which has largely been satisfied with imports from the neighbouring producing regions. Due to its strategic geographical location Turkey was successful in negotiating favourable deals in its natural gas imports, in addition to receiving sizeable transit benefits. The adoption of the EU third energy package threatens the ability of the AKP government to continue doing so. The energy

[553] *World Report 2016* (USA: Human Rights Watch, 2016), pp. 578–585; *Amnesty International Report 2015/16: The State of the World's Human Rights* (London: Amnesty International, 2016), pp. 369–373.

[554] See e.g. Ziya Öniş, 'The Triumph of Conservative Globalism: The Political Economy of the AKP Era', *Turkish Studies*, 13.2 (2012), 135–52.

policy of the current Turkish government would (likely) have reverberations on the economic growth. In order to avoid this and accordingly, the popularity of the ruling party, it is seems all the more rational for the AKP government to not adopt the natural gas *acquis*.

3. Main findings and implications on the SGC

This chapter argued that, although Turkey is an EU candidate, transposition and application of the EU's energy *acquis* in the country has not been easy and successful ever since the start of the accession negotiations. As was investigated in detail above, several factors play inhibitive role in the way of Europeanisation of Turkey's energy sector. Despite Turkey's a quarter of a century old membership application, the achievement of the final reward is still uncertain if not impossible. Nevertheless, this uncertainty in eventual membership can only partially explain the overall compliance with the EU *acquis*, as the application of the EU energy *acquis* to Turkey is not non-existent, but is rather selective.

That is to say, the Turkish government is keen on capitalising on the EU experience in certain sectors of the energy system (renewables, electricity sector and in terms of energy efficiency), but reluctant in others (natural gas). To this end, I have argued above that, such a selective implementation of the EU *acquis* can be explained by the net domestic costs that Turkey will incur in adopting the EU natural gas legislation without ensuring credible and foreseeable membership prospects.

In this vein, we can observe that there are two opposite trends taking place in Turkey's energy policy with regard to renewables and electricity sector on the one hand and natural gas sectors on the other. To start with, Turkish government seems to be keen on tapping into the domestic renewable energy sources and liberalising domestic electricity sector. In doing so, it is willing to capitalise on the EU practice and ensuring market convergence and integration with the neighbouring countries, including the EU.

However, when it comes to the national gas market, the Turkish government seems to be paying only lip service to harmonising its domestic policies with that of the EU and ensuring freedom of gas transit across its territory. In reality, the government is keen on holding onto its formal capacity to exert control over the transit of gas across its sovereign territory and hereby, influencing regional (continental) energy trade and geopolitics.

In this context, the preferences of the Turkish government is exogenous to the process of institutional reforms that it has enacted or refrained from enacting, that is to say, to institutional outcome. In other words, the institutions that it is confronted with (EU energy *acquis*) do not serve as a basis/template of good or bad behaviour/action. They rather present options for policy choice, the selection or non-selection of which is determined by the costs incurred or benefits accrued. What constitutes a cost or benefit is determined by the preferences of the Turkish government, which are or can be affected by the acceptance or non-acceptance of the EU *acquis* (formal institutions); however, they are not conditioned (affected) by them as scripts of appropriate behaviour. In other words, *preferences* are determined outside the process of decision-making on whether to adopt or reject the EU rules.

In practice, these *preferences* are related to Turkey's role in energy relations. Turkey is a growing consumer, as well as a key transit country on the way towards the EU markets. Therefore, the power to affect energy transit/trade across its territory feeds into the political and economic muscles of the Turkish government and plays a central role in Turkey's (geo)economic and (geo)political strategy. Thus, as explained by the RCI, the interaction of Turkey with the EU-sourced *formal institutions* (in our case, their adoption or rejection) is juxtaposed against its preferences (related to energy security) in a strategic setting, the outcome of which is determined by a rational action, namely, measuring expected costs against benefits.

As this chapter argued, structurally, it appears that institutionalisation of Turkish natural gas sector under the EU template, without tangible progress in EU accession negotiations is likely to confer upon Turkey heavy *net domestic costs*. Therefore, in line with the predictions of the EIM, the Turkish government's choice to not to apply EU legislation domestically is only rational for it will allow Turkey to hold on to its national control of energy transit across its territory and keep on taking advantage of its material benefits.

From the view point of the central thesis of this PhD, this outcome will likely entail transit implication on the EU supply of natural gas via the SGC across Turkey. This is rather because, freedom of transit across the SGC could only be achieved if the regulatory regime for the corridor were ensured in such a way that the ownership of gas volumes transported via the major infrastructure(s) were less relevant (immaterial) for the owners and the operators of this very infrastructure(s). In the case of Turkey, separation of the gas supply and transportation activities of BOTAS and the implementation of regulated TPA regime within Turkey, would have allowed third countries to engage in direct energy relations with the EU without being hindered by Turkish government's or BOTAS's

commercial and political interests. Hence, as BOTAS (or any other company owning the transmission lines) would not be able to discriminate among domestically destined or transiting gas in terms accessing Turkish domestic transmission (or transit) lines, energy export to the EU or any other consumer markets via Turkey would then be determined solely based on market fundamentals. As I have investigated in the current chapter, this has not been the case in the Turkish section of the SGC.

Despite the progress achieved with regard to TANAP, the necessity of establishing EU-sourced regulatory regime in Turkey remains all the more relevant. The maximum transportation capacity of TANAP is only 31 bcm/a, 16 bcm/a of which has already been contracted for 25 years for the transportation of SH II volumes to the EU and Turkish markets. The remaining available capacity of TANAP can easily be filled with volumes to be produced from other fields in Azerbaijan, such as Umid, Absheron, Babek, etc. As TANAP does not envision regulated (mandatory) TPA regime, it will not guarantee transit capacity for, for example, Iranian, Iraqi or Turkmen gas when/if they become available. This will likely require the usage of the Turkish national transmission system for the transportation of these Middle East and Central Asian gas volumes to the EU. This, on the other hand, will still necessitate the establishment of a favourable to transit regulatory regime in Turkey, whether through Europeanisation of the Turkish domestic legislation or based on intergovernmental agreement that provides equal pipeline access opportunities for all the relevant third-party gas. Therefore, without the establishment of a proper transit regime in Turkey, the Southern Gas Corridor risks being limited to current export capacity (10 bcm/a), which will provide only limited contribution to the improving the resilience of the EU energy security.

Consequently, this means that under current circumstances, supply of natural gas to the EU via the Turkish segment of the SGC will not conform to the former's conception of energy security, which includes both the diversity, as well as the competitiveness of the supplied energy. Since *competitiveness* criterion requires the elimination of non-market interference to energy supply/transit, in the case of Turkey, it can be concluded to be a failed effort.

CHAPTER V: EUROPEANISATION OF GEORGIA's NATURAL GAS SECTOR & SGC

1. Introduction

East of Turkey the territory of Georgia constitutes an important segment of the SGC. The country's strategic geographical location between the Caspian energy producers and the European consumer regions makes it an indispensable *transit* country for the export of these energy resources to the European consumers. On the one hand, this strategic position allows Georgia to ensure its own energy security. From the EU perspective, on the other hand, Georgia's *transit* location can present economic and political risks for the transfer of Caspian energy riches to the European market, regardless of the country's West-friendly political orientation. Although modest compared to Turkey, these risks stem from Georgia's national interests to exact favourable terms from the Caspian producers in purchasing natural gas for domestic supply, as well as receive additional benefits in allowing *freedom of transit* across its territory. Therefore, Georgia has come to be part of the EU's SGC strategy not only in physical/hardware terms, but also from the institutional/regulatory point of view.

While the EU's vision for designing the regulatory framework of this alternative energy corridor is the same across all the countries - through the extension of the EU domestic energy governance norms over the SGC countries - the nature/mode of the individual bilateral relations between these countries and the EU is considerably different. That is to say, due to its candidate status, Turkey is by default required to transpose the whole body of the EU law into its domestic legislation before it can be *let in*. Thus, the nature of the relations between Ankara and Brussels is hierarchical, which I have investigated at length in the previous chapter.

However, as I have presented in detail in Chapter III, with the SGC states of Eastern Partnership, the EU's relationship is *under the membership line.* That is to say, neither Georgia, nor Azerbaijan has been granted a candidate status and the latter has not even expressed its desire to become a member of the EU anytime soon. Therefore, the nature of relations between Georgia (and Azerbaijan) on the one hand and the EU on the other is less asymmetrical than the one between the EU and Turkey. In this regard, what we see here is a two tier power relationships between the EU and the individual countries of the Southern Gas Corridor.

These differentiated power relations are underpinned by the different levels of incentives offered by the EU to the EaP countries in return to their adoption of the EU *acquis*, including the EU legislation in natural gas sector. As I have argued in Chapter III, despite the inferior incentives offered vis-à-vis the accession process (association vs. membership), the EaP envisages similar level of reforms to be carried out by the partner countries, including Georgia. Hence, assuming that as a vital transit and energy consumer country, Georgia shares similar (although not identical) energy security interests with Turkey (which I analyse inductively below in this chapter), then costs associated with the adoption and implementation of the EU *acquis* by Georgia can be expected to be high, as well. Thus, under the rationalist logic of the External Incentive Model it can be anticipated that, Georgian government will find it difficult to implement the EU Third Energy Package domestically given the high adoption costs associated with it. With these in mind, in the current chapter I analyse the domestic energy-related constraints in Georgia in order to unearth the factors, which affect the Europeanisation of its natural gas sector.

By taking advantage of the conceptual and theoretical tools from Europeanisation literature, I aim to unearth and analyse the factors that will potentially affect the functioning of the SGC as an alternative energy supply corridor to the EU. Consequently, this will enable me to investigate the contribution of the SGC to the EU's conception of energy security, which includes both the *diversity* and *competitiveness* of energy supply.

With this in mind, first, this chapter investigates the level of legislative approximation between Georgia and the EU in natural gas sector. Then, it provides a thick analysis of the domestic factors in Georgia that brought about the current state of outcome in rule adoption process. Finally, it assesses these findings in the context of natural gas supply across the Georgian segment of the SGC and its potential implications on the competitive gas supply to the EU via this corridor.

2. Europeanisation of the natural gas sector of Georgia

As part of the Eastern Partnership, the EU signed an Association Agreement with Georgia on Jun 27, 2014. As described in Chapter III, the EU-Georgia AA envisages contractual obligation on the part of Georgia to apply both the main principles, as well as specific provisions of the EU natural gas *acquis* as part of the *DCFTA* and *sectoral* sections of the mentioned agreement. In addition, Georgia will have to apply the principles and the specific provisions of the EU energy *acquis* when and if its accession process to the Energy Community Treaty is successful. However, as it was underlined by the interviewees at the

European Commission and the EEAS, it leaves a lot of doubt and questions as to how deep and successfully EU legislation can be implemented in Georgia.[555] In order to understand this, it is necessary to have a comprehensive picture of Georgia's domestic energy landscape.

The Ministry of Energy - has the primary responsibility over the state policy in the energy sector. It is in charge of drafting the national energy policy and submitting it to the Parliament for approval and for developing and implementing short-medium- and long-term strategies and priorities for the energy sector of the country.

Georgian National Energy and Water Supply Regulatory Commission (GNEWRC) - is the relevant national autonomous regulatory body, which (also) establishes and regulates tariffs for natural gas transportation and distribution activities. GNEWRC is responsible for drafting and approving the tariff methodology and licensing rules. Natural gas supply activities are deregulated, thus, no licence is required for these activities. The 2005 amendments to the Law on Electricity and Natural Gas have stripped some regulatory rule-making powers from the regulatory authority and transferred these to the Ministry of Energy in gas & electricity sectors. The amended law gives the Ministry the authority to approve the natural gas balance and the natural gas market rules.

Georgian Oil and Gas Corporation (GOGC) - is a joint stock company and 100% owned by the Ministry of Energy with management rights. GOGC administers state's share of natural gas (and oil) obtained under the relevant production sharing agreements (PSA) and manages its storage, transportation and sale operations and controls the import of gas to the Georgian wholesale market, although gas sector is liberalised in nominal terms.

Georgian Gas Transportation Company (GGTC) – is the operator (TSO) of the transmission lines owned by the GOGC. GGTC itself is 100% owned by the Georgian Ministry of Energy. In this regard, GGTC is legally unbundled from GOGC.[556] GGTC is in charge of the transmission level network activities, including commissioning, rehabilitating and replacing existing oil & gas pipelines and constructing new ones in the territory of Georgia.

Under the current Georgian legislation, third-party access to the transmission system is regulated[557] and any party that seeks access to the transmission system for the purpose of receiving natural gas must submit a special request to GGTC (TSO). GGTC may decline the request only in case if the connection of the parties (a licensee or direct customer) to

[555] Interview Douglas Carpenter, EEAS, 16/05/2013, Brussels, as well as with the EC official directly involved in the SGC negotiations, 07/05/2013, Brussels.
[556] *INOGATE Programme: Status Report 2011* (Kiev: INOGATE Technical Secretariat, October 2012), p. 12.
[557] *INOGATE Programme: Status Report 2011*, p. 12.

natural gas transmission system may have a negative impact on the system as a whole. Access tariffs to the transmission lines is established and regulated by the GNEWRC.

Domestic distribution networks - are privatised. KazTransGaz Tbilisi and SOCAR Georgia Gas (SGG) control the distribution segments of gas transportation. Access to the distribution networks is carried out by tariffs, which are established and regulated by the GNEWRC.

Georgia imports gas for domestic consumption from Azerbaijan, as well as from Russia in the form of (*transit*) payment for Russian gas transit to Armenia. In addition, since Georgia also acts as a transit corridor for Azeri gas exports to Turkey and Europe, it receives a share of transported volumes as a *transit fee*, which amounts to 5% of the transiting gas.[558]

In this regard, although Georgia has gone a long way in applying international practices in domestic energy market, it does not entirely comply with the broad principles enshrined in the EU *acquis* (and the EU-Georgia AA). Firstly, although (legal) *unbundling* is applied vis-à-vis the Georgian domestic transmission system, the South Caucasus Pipeline (SCPx), which constitutes the first leg of the Southern Gas Corridor and crosses Georgian territory in transit, does not apply this regulatory requirement. The SCPx is owned and operated by the supply (upstream) companies, which contradicts the EU legislation. Thus, in the context of the Europeanisation of the SGC, Georgia has yet to comply this benchmark of the EU's external energy governance.

Secondly, similar to unbundling requirements, TPA in Georgia is applied only vis-à-vis the domestic transmission lines, hence, leaving the SCPx outside this legal requirement. Thirdly, the broad *"transit"* principle under the EU legislation (as well as the EU-Georgia AA), which eliminates the transit fees by the transit countries is yet to be applied by Georgia, as the country still receives *transit fees* from the Caspian gas exporters in the form of free gas off-takes.[559] Although it may initially seem insignificant, these (5%) transit off-takes can have substantial influence on the economic viability of natural gas supply via the SGC. For example, under the Shah-Deniz phase II, 16 bcm/a of gas is contracted for Turkish and EU markets. This means that in order to ensure the transit rights of these volumes across Georgia, Shah-Deniz consortium has to provide up to 800 mcm/a of gas to Georgia *free of charge*. If to consider an average price of €300 for every 1000 cubic metres

[558] The information on Georgia's domestic energy landscape was acquired during the in-depth phone interview with the relevant official from SOCAR, 21/04/2015. In addition, reports from the European Bank for Reconstruction and Development (EBRD) and INOGATE programme were used. See e.g. 'Strategy for Georgia' (The European Bank for Reconstruction and Development, 2013); *INOGATE Programme: Status Report 2011*.

[559] See e.g. 'Инфраструктура для реализации проекта "Энергетический мост Азербайджан-Грузия-Турция" практически готова (The Infrastructure for Realisation of Project "Energy Bridge Azerbaijan-Georgia-Turkey) Is Practically Ready)', *OilCapital.ru*, 12 September 2014 <http://www.oilcapital.ru/industry/252148.html> [accessed 24 October 2015].

of gas sold in the EU, Georgian off-takes will cost the Shah-Deniz consortium €240 mln annually or €6 bln during the 25 years, which is the length of the gas supply contracts to the EU consumers signed as part of the SD II. Whether compensated at the expense of the gas suppliers, or passed on to the EU consumers in the final price of natural gas, these figures prove that the economic impact of the *freedom of transit* across Georgia is considerable. This is especially true given the fact that, the netback value of every 1000 cubic metre of natural gas sold in the EU is usually around €50. If to consider the transit of Central Asian gas across Georgia (at some point in the future), then transit risks in Georgia rises exponentially.

Against this backdrop, as I will illustrate below, although Georgia is legally bound by the relevant provisions under the EU-Georgia AA and in the future by the EnCT membership, the government is very reluctant to implement EU-sourced reforms in the foreseeable future, for they will incur considerable domestic costs.

In the following sub-sections, based on the rational-choice analytical framework, I utilise External Incentive Model in order to reveal the underlying factors affecting the failure of rule adoption in Georgia. This model predicts that, "*A government adopts the EU rules if the benefits of EU rewards exceed the domestic adoption costs*".[560] With this in mind, the following sub-sections will analyse the role of *size and speed of reward, credibility of conditionality* and *the net domestic costs* & *veto holders* in the failure of the EU-sourced energy reforms in Georgia.

2.1. Size and speed of final reward

As I indicated above, the *finalité* of the EU-Georgia AA is under the membership line. Thus, even though Georgia has clearly voiced its EU membership aspirations, the current contractual arrangement does not even hypothetically guarantee this prospect. Additionally, although the DCFTA part of the EU-Georgia AA enables Georgia to access EU single market without customs barriers, its relevance to trade in natural gas is irrelevant, for Georgia does not own natural gas resources of its own and plays only a transit role, while satisfying with transit benefits received from major Caspian gas exporters. In other words, neither the AA nor its DCFTA promise sizeable rewards for Georgia as far the natural gas sector is concerned.

In this context, Georgia's EnCT membership application can be analysed as a policy strategy in order to enhance its EU membership prospects. Since Georgia is not physically

[560] Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 12.

linked to EU market, EnCT membership will not provide Georgia with tangible energy security benefits, in terms of solidarity in times of energy shortages or energy diversification options via reverse gas flows. Thus, EnCT membership seems to be only a symbolic gesture, which an EC official interpreted as strategy on the part of Georgia to *legitimise* its EU membership prospects under the preamble of the Energy Community Treaty. The preamble in principle provides EU membership prospects for the contracting parties.[561]

Despite these efforts, the prospect of the big reward - EU membership - is far from being promised by the EU. Each successive Eastern Partnership summits presented even less optimism than the prior ones. Hence, since under the current contractual arrangements the final reward for rule approximation envisages only association without tangible material benefits, Georgia is not keen on rushing to implement, *inter alia*, EU natural gas *acquis* in the foreseeable future.[562]

It is also important to note that, Georgia's efforts to legitimise its EU membership prospects does not necessarily stem from the *legitimacy* of the EU rules or the understanding thereof as such by Georgia. Quite the opposite, Georgia seems to use it out of strategic logic in order to further its ultimate aim, which is the EU membership. Hence, one should not confuse the logic of legitimacy (appropriateness) with the logic of strategic (rational) choice governing the behaviour of Georgian authorities.

Nonetheless, it is my position that, in itself the size and the speed of final reward does not necessarily explain underlying reasons why Georgia is so reluctant to adopt EU natural gas *acquis*, whether under the EU-Georgia AA, EnCT membership or any other bilateral or multilateral instruments, such as Twinning or INOGATE programmes. This requires further analyses in order to unearth additional factors, which condition the reluctance on the part of the Georgian authorities when it comes to approximation in natural gas sector. To that end, I below analyse the credibility of conditionality as an additional underlying factor in this process.

2.2. Credibility of conditionality

As I illustrated above, DCFTA and sectoral parts of the EU-Georgia AA envisages access to the EU single market and the right to participate in the functional Union programmes and

561 Interview with EC/DG Energy official, 03/05/2013, Brussels. The same logic was also reluctantly admitted by a senior Georgian diplomat during a separate interview, 16/04/2015, Brussels.

562 Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

agencies in return to the approximation of domestic rules with the EU *acquis*. Nevertheless, this conditionality based on more-for-more principle is not aggregated as far as the final reward for compliance is concerned. That is to say:

- DCFTA includes measures that can restrict the partner country's access to the single EU market in case of non-compliance in the agreed timeframe and/or depth of harmonisation until Georgia provides the necessary remedies. However, non-compliance in once sector, e.g. natural gas, will not limit market access in all the areas of free trade between Georgia and the EU. In other words, as the relevant Georgian diplomat put it, *"if we [Georgia] do not comply with energy acquis, we can still export apples to the EU market".*[563]
- In sectoral part, additionally, there are no punishment and/or enforcement mechanisms, as the partnership is based on the "good-will" of the partner countries. Obviously, this can entail political pressure in the political dialogue institutions - Association Council and Association Committee. However, the AA does not envisage anything in terms of sanctions.[564]

In this regard, the credibility of conditionality, especially enforcement mechanisms are not so stringent as opposed to the EU accession process, nor they are interlinked among different sectors of bilateral partnership. This, consequently, will allow Georgia to tailor the depth and timeline of the implementation of the EU *acquis* to its domestic preferences.

Nonetheless, although the lack of credible enforcement mechanisms in the EU-Georgia AA can explain Georgia's current inclination not to rush with the approximation process in natural gas sector, it nevertheless does not provide a credible answer to the question: ***How does Georgian government decide which rules to adopt and which not?*** In other words, what are the factors that directly mediate between the preferences of Georgia and the adoption of the EU rules in natural gas sector? This is especially a germane question given the fact that, Georgia is keen on taking advantage of the EU model in electricity sector organisation and integrating into the regional electricity markets.[565] As such, if the lack of credibility of conditionality was the main reason for the lack of or propensity for rule adoption, then it should have been observed across the board in the energy sector. Therefore, it is necessary to analyse the role of domestic net adoption costs and domestic veto holders, as they directly mediate between the preferences of the government and the outcome of the rule adoption process. They are especially relevant for the role of Georgia

[563] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels
[564] Interview with Salome Salukvadze, Mission of Georgia to the EU, 24/04/2015, Brussels
[565] Interview with an official from the Georgian Ministry of Energy, 03/06/2015, Brussels.

as a key transit country along the SGC, for they relate to the potential impact of the Georgian national interests on the *freedom of transit* across this country, hence, competitiveness of EU gas supply via the SGC. I analyse these factors in the following section.

2.3. Net adoption costs and veto holders

2.3.1. Net adoption costs

The biggest point of apprehension for Georgia stemming from the approximation towards the EU *acquis* is the transit benefits that country currently receives from the natural gas pipelines traversing its territory from the East to West, as well as from the North to South. The former is related to the transit of Caspian (currently only Azeri) gas volumes to the Turkish and in the future to the European markets via the South Caucasus Pipeline (the first leg of the SGC), while crossing the sovereign territory of Georgia. In return to this transit right, Georgia currently receives transit fees in the form of free gas volumes under the Host Government Agreement (HGA) with the South Caucasus Pipeline Company (SCPC). The Georgian Oil and Gas Corporation later uses these free gas volumes to lower the wholesale gas prices for the domestic consumers.[566]

Furthermore, due to its strategic location between the gas production and consumption regions and currently being the only viable Western transit route for the Caspian gas, Georgia is able to exact favourable gas import prices from Azerbaijan for its domestic consumption. In this regard, if Georgia implemented the EU *acquis*, then it would have to let go of the transit and domestic benefits it currently receives. This is rather because, as I indicated in Chapter III, EU energy *acquis* prohibits transit fees to be charged for transiting gas. In addition, since under the EU-Georgia AA/DCFTA Georgia must not hinder the transit gas across its territory, then the government would be in a worse negotiating position in exacting cheaper gas prices from Azerbaijan for its domestic consumption.

Indeed, this would be beneficial for the EU, for any reduction of costs of EU-destined gas in *transit* might be passed on to the final EU consumers or make currently commercially unfeasible upstream projects viable or simply increase the gas producer's netback. In contrast, the application of the EU *acquis* would not generate any benefits for Georgia in order to offset these potential costs.

[566] Interview with the relevant official from SOCAR, 21/04/2015.

These concerns would apply not only with regard to the transit of Azerbaijani gas, but also Russian gas exports to Armenia while crossing Georgia along the North-South axis. Unlike the former, in the latter case Georgian government owns the North-South transmission line, which connects Russia with Armenia across Georgia. In this case too, Georgia receives transit benefits in the form of free gas, which covers around 10% of the country's domestic demand.[567] In this case too, the application of the EU *acquis* in Georgia would deprive the country of these transit benefits, for the EU *acquis* would have to be applied uniformly without discriminating among different stakeholders. For this very reason, despite the legal commitment under the EU-Georgia AA to carry out reforms in approximating domestic legislation to the EU *acquis*, Georgian government is keen on to continue receiving transit benefits for a considerable period of time; thus, it will take a strong negotiations position when determining the timeline and depth of implementation, which is not prescribed by the EU-Georgia Association Agreement.[568]

In itself, it is difficult to predict any comparable costs or benefits for Georgia regarding the application of *unbundling* and *guaranteed TPA* provisions, which are also envisioned in the EU *acquis* in addition to the elimination of the *transit fees*. For the owners of the SCPx, which would have to be unbundled, however, this would incur extensive commercial and strategic risks, as they would not be able to exercise control over the access regime of their own pipeline. In theory, unbundling and guaranteed (regulated) TPA regimes could be applied before/without the elimination of the *transit fees*, hence, giving the Georgian government a leeway to continue benefiting from the latter for a sometime. However, this would likely to unleash a chain of reactions from the pipeline owners, as their rights to pipeline ownership and operatorship is guaranteed under the bilateral inter-governmental and host government agreements.[569] Violation of the terms of this agreement would likely have a knock-on effect on the above-mentioned transit benefits and cheap gas imports, for the Georgian governmental would no longer be able to leverage its geographical location to that end.

In other words, if the gas producers in Azerbaijan, who control the major gas transit pipeline across Georgia were to be deprived of their ability to own and operate thereof (due to the EU *unbundling* and *TPA* rules), then they would be left with no incentives to provide Georgian consumers with discounted gas prices in return. Hence, if Georgia were

[567] Interview with an official from the Georgian Ministry of Energy, 03/06/2015, Brussels.
[568] Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.
[569] Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

to fully approximate its energy legislation with that of the EU, then it would have to let go of both cheap gas and transit benefits.

The government in Tbilisi is aware of these economic and ensuing political risks, for it could also affect Georgia's political sovereignty. Azerbaijan and Georgia have been enjoying friendly political and business relationships since regaining their independence following the break-up of the Soviet Union. This includes, among others, close cooperation in the sphere of energy security.[570] Azerbaijani gas supplies to Georgia came very handy in 2006 when Russian Gazprom declared its intention to up the gas sale prices to Georgia from then 110 USD to new 230 USD after the West-friendly Rose Revolution in Georgia.[571] Russian request followed a blackmail strategy, as it made the maintenance of the old prices to Georgia's selling off the North-South gas pipeline to the Russian gas giant Gazprom. The latter delivers gas from Russia to Georgia and Armenia (currently mainly to Armenia) across the Georgian territory.[572] In order to close the circle around Georgia, Russia even invited Azerbaijani president Ilham Aliyev to join the "anti-Georgia Alliance",[573] which the latter (diplomatically) refused. Mindful of these risks, therefore, Georgia is interested in such a *timeline* and *depth* of approximation that would allow it to continue benefiting from the above-mentioned benefits for a considerable period of time.[574]

Furthermore, it is also worth analysing the impact of the EU *acquis* on the distribution level of gas supply to the Georgian domestic consumers. From the perspective of the Southern Gas Corridor, this would not affect the export of Caspian gas to the EU markets. Nonetheless, it would incur additional costs for the domestic Georgian gas market and individual consumers.

Since 2012, State Oil Company of Azerbaijan Republic has bought most of the regional distribution assets and started carrying out extensive gasification programme into the remote areas in Georgia.[575] The gasification portfolio is aimed at providing isolated parts of the Georgian population with secure gas; hence, it can be considered as an integral element of Georgia's energy security. Under the agreement with the Georgian government,

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570 Zaur Shiriyev and Kornely Kakachia, 'Azerbaijani-Georgian Relations: The Foundations and Challenges of the Strategic Alliance', *SAM Review*, 7-8 (2013).

571 'Saakashvili: Georgia Will Not Pay "Political Price" for Gas', *Civil Georgia*, 14 November 2006 <http://www.civil.ge/eng/article.php?id=14085> [accessed 2 March 2014].

572 'Gazprom Wants "Georgian Assets" in Exchange for Cheap Gas', *Civil Georgia*, 7 November 2006 <http://www.civil.ge/eng/article.php?id=14032> [accessed 2 March 2014].

573 'Reports: Putin to Urge Aliyev to Join "Anti-Georgian Alliance"', *Civil Georgia*, 9 November 2006 <http://www.civil.ge/eng/article.php?id=14042> [accessed 2 March 2014].

574 Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

575 Interview with an official from SOCAR Georgia Gas, 21/04/2015.

SOCAR is envisaged to provide gas to at least 150 000 new (potential) customers and invest at least $40 million into the gasification programme of Georgia. However, it is expected that investments in Georgia will significantly surpass this amount.[576]

In this regard, the application of the EU *acquis* would require SOCAR Georgia Gas (a subsidiary of SOCAR) to comply with the unbundling provisions, too, for under the EU legislation, unbundling covers both transmission and distribution networks. SOCAR currently owns both the distribution network assets, as well as acts as a supplier of the final customers in Georgia.

In this regard, although Azerbaijan has officially indicated that it would not object to the application of the EU's third energy package in Georgia,[577] the latter would directly undermine SOCAR's business in the country. This is rather because, under the EU *acquis* SOCAR would have to undergo functional, legal and account unbundling of its gas distribution services in Georgia and ensure mandatory third party access to its distribution networks. Since there is a commercial link between SOCAR's gasification programme and the control and operatorship over the distribution networks, unbundling regime would run the risk of making SOCAR's gasification business commercially unviable. This, on the other hand, would likely result in the disruption of the gasification process and undermine the energy security of isolated Georgian citizens.

In light of this, the absence of realistic alternatives to Azerbaijani gas supplies in the region is likely to create prohibitively high domestic costs for Georgia to Europeanise its natural gas sector, while (also) undermining the interests of Azeri SOCAR. Obviously, there are other potential gas producers in the region, which if delivered to Georgia following the application of the EU *acquis*, could provide diversification and competitiveness in the Georgian natural gas market. These were highly speculated following the ascend to power of the Georgian Dream coalition in 2012.[578] However, the vicinity to production regions does not necessarily translate into secure gas supplies.

The restart of Russian gas supply to Georgia is a highly unlikely scenario in the foreseeable future. Georgia stopped buying gas from Russia following the 2006-2007 "pricing dispute".[579] Trade and political relations, on the other hand, were entirely severed

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576 Interview with an official from SOCAR Georgia Gas, 21/04/2015.

577 'Azerbaijan Not to Raise Questions Regarding Georgia's Entry into EU Energy Community', *ABC.az*, 27 November 2013 <http://abc.az/eng/news_27_11_2013_77685.html> [accessed 16 February 2014].

578 'Kakha Kaladze: Georgia May Resume Gas Purchases from Russia', *APA.az*, 7 May 2013 <http://en.apa.az/news_kakha_kaladze__georgia_may_resume_gas_pu_192420.html> [accessed 20 May 2015].

579 In fact, it was more of a political reaction on the part of Kremlin to Georgia's Western aspirations following the "Rose Revolution". See e.g. Svante E. Cornell, *Georgia after the Rose Revolution: Geopolitical Predicament and Implications for U.S. Policy*, The U.S. and Russia : Regional Security Issues and Interests (Carlisle, PA: Strategic Studies Institute, U.S. Army War College, 2007); Niklas Nilsson, 'Georgia's Rose Revolution: The Break

following the Russian invasion of Georgia in 2008,[580] which has not improved ever since. In addition, one has to also scrutinise the relative competitive advantage of Azeri gas exports to Georgia vis-á-vis Russia, which stands at just over $200 per thousand cubic metres.[581] Russian gas export prices to Armenia, the Kremlin's most loyal ally in the South Caucasus, constituted $270 per thousand cubic metres before the country announced its desire to join Russian lead Customs Union. Only after Armenia's decision to join the Customs Union and sell of the rest of shares in the Armenian gas distribution company to Gazprom, the latter lowered gas sales prices to $189 thousand cubic metres.[582] In this vein, it does not take much to come to the conclusion that Georgia is unlikely to get lower gas prices from Russia unless it follows in the footsteps of Armenia and choses Customs Unions at the expense of a free trade agreement with the EU. Furthermore, Russian gas sales prices to Georgia would likely be higher than Azeri gas, due to the high production and transportation costs from Russian gas extraction fields situated far afield the Georgian borders. Quite the opposite, the Georgian government could not only realistically expect cheaper gas prices from Russia, but it is also mindful of the political/strategic dangers of further liberalisation of the domestic gas market (which is also envisioned by the EU-Georgia AA and under the EnCT), because of the possibility of Russian company entering Georgian market.[583]

Kazakh gas supply to Georgia is also an unlikely scenario. Most of the country's gas production is whether injected back into the production fields in order to increase oil output or used for domestic consumption. Furthermore, although supplies from Kazakhstan could, in principle, constitute a source diversification, Kazakh gas would have to traverse Russian territory in order to reach Georgia. This, on the other hand, would not address the transit dimension of security of gas supply and would bring Georgia back to the table of Russia-Georgia bilateral political relationships. In addition to the security of supply concerns, Kazakh gas supplies to Georgia would also include Russian transit fees, which would make new supplies even more expensive than Azeri gas, hence defeating the efforts for competitive gas pricing.

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with the Past', in *The Guns of August 2008: Russia's War in Georgia*, ed. by Svante E. Cornell and S. Frederick Starr (M.E. Sharpe, 2009), pp. 85–103.

580 *The Guns of August 2008: Russia's War in Georgia*, ed. by Svante E. Cornell and S. Frederick Starr (M.E. Sharpe, 2009).

581 Alex Jackson, 'Georgia Looks Longingly for New Gas Suppliers', *Natural Gas Europe*, 3 June 2013 <http://www.naturalgaseurope.com/georgia-natural-gas-suppliers> [accessed 3 August 2014].

582 Tigran Gevorgyan, 'Russian Energy Giant Captures Armenian Market', *Institute for War and Peace Reporting*, 24 January 2014 <http://iwpr.net/report-news/russian-energy-giant-captures-armenian-market> [accessed 3 August 2014].

583 Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

Another alternative, Turkmen gas would have to traverse Azerbaijani territory in order to reach Georgia, as well (or be transported via Caspian-Coastal Pipeline and Russian territory, which would be only self-defeating from political viewpoint). Without a negotiated access to the main highways across Azerbaijan and the physical construction of a Trans-Caspian Pipeline, third energy package would do little to help Georgia to diversify its gas supplies.

Another potential supplier, Iran is having a difficult time of its own, in terms of meeting its own domestic demand due to the Western sanctions. Iran currently supplies gas to Armenia and gas exports to Georgia across Armenia is a theoretical possibility. However, it would have to address the reverse flow capacity first between Georgia and Armenia or construct entirely a new pipeline. Additionally, Russian Gazprom controls gas import and transportation pipelines from Iran across Armenia.[584] In the absence of friendly or neutral diplomatic relations between Tbilisi and Moscow, it would not unreasonable to expect Gazprom's disinterest in facilitating gas Iranian gas sales to Georgia.

Such a situation effectively leaves Georgia at the goodwill of the regional states, which were to serve as transit countries for supplies volumes other than from Azerbaijan. Quite ironically, although surrounded by the regions producing three quarters of global gas production, Georgia seems to be bound to continue “friendly” partnership with Azerbaijan and take into account its interests when progressing in its EU integration. It is highly unlikely that Azerbaijan could afford or would resort to extraordinary measures to enforce its interests in Georgia. Nonetheless, friendly cooperation between the two countries has stood at the core of Georgia's energy security throughout the last decade. Therefore, any actions undermining these relationships could produce prohibitively high costs for the Georgian authorities.

Last but not least, it is also important to note that the existence of these potential net adoption costs could affect not only the implementation of the natural gas specific provisions of the EU-Georgia Association Agreement, but also Georgia's future membership in the EnCT. As I argued above, Georgia does not have any direct physical links with the EU territory in order to take advantage of the market access benefits of the EnCT membership. Nonetheless, EnCT also provides the possibility of regional market creation and integration, without its direct physical connection with the EU single market. That is to say, the legislative framework of EnCT could be used to foster the establishment of a regional market between, e.g. Georgia, Azerbaijan, Armenia and even Turkey. According to Georgian officials, this was one of the main motivations of Georgia in

[584] Gevorgyan, ‘Russian Energy Giant Captures Armenian Market’.

applying for the EnCT membership. However, since none of the regional states followed suit in EnCT membership aspirations, the weight of the looming *acquis* approximation costs has so far slowed the EnCT accession process of Georgia.[585]

2.3.2. Veto holders

In terms of the veto holders in Georgia's domestic policy-making, several actors can be identified. Georgian Ministry of Foreign Affairs has been a champion of closer cooperation with the EU in energy sphere and is a strong supporter of Georgia's current accession bid to the Energy Community Treaty, as well as the closer integration into the EU markets. The MFA sees the EnCT accession bid as a powerful political commitment to Georgia's EU integration objectives. However, the MFA is also mindful of the transit benefits that Georgia will have to let go of if it implements the EU *acquis* and is not a veto holder as regards the final decision in the EnCT membership or the current and future legislative approximation process.[586]

Secondly, the *Economic Council* of Georgia, which encompasses all the relevant state institutions that are involved in the state's economic policy-making, including the Ministry of Energy, has a different take on the legislative approximation process and Georgia's EnCT membership bid. They want to maintain more control over the economic aspects of the state's energy policy, especially vis-à-vis the tariffs and transit benefits linked to the transit of Azerbaijani gas across Georgia.[587] Since the value of total transit benefits is a commercial secret, it is difficult to estimate its contribution to the daily economy of Georgia and economic costs vis-à-vis the potential benefits. However, one point can be safely argued that, the elimination of transit benefits (natural gas *free of charge*) would likely result in higher wholesale gas prices in Georgia, for the country would no longer be able to acquire a certain share of its gas basket free of charge. This would likely be unpopular among Georgians, who have voted for a government promising the reduction of household utility bills.[588] Natural gas provides considerable share of total energy consumption in urban Georgia. Any increase in natural gas prices would directly impact the household well-being and hence, the popularity of the 'Georgian Dream' coalition among the mobile urban electorate.

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585 Interview with an official from the Georgian Ministry of Energy, 03/06/2015, Brussels.

586 Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

587 Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

588 'Promise # 5: Price of Natural Gas Will Be Reduced by 2/3', 2015 <http://dreammeter.ge/en/dapireba-5-gazis-safasuri-shemcirdeba-samjer/#sthash.GG8oSDup.dpuf> [accessed 5 December 2015].

Thirdly, the Georgian Ministry of Energy has the primary responsibility over state policy in the energy sector and is in charge of drafting the national energy policy and legislation and submitting it to the national Parliament for approval. Although some individuals within the Ministry are in favour of closer integration with the EU and quicker EnCT accession process, the Ministry is not yet decisive on the approximation process mindful of the economic costs it would bring to the country's natural gas sector.[589] Quite the opposite, by using the isolated market status (not directly connected to the EU market), the Ministry is planning to negotiate exemptions from the EU third energy package as part of the implementation of the *sectoral* provisions of the EU-Georgia AA/DCFTA.[590]

Furthermore, both of the Georgian state-owned natural gas companies, GOGC and GGTC are important stakeholders in the internal governmental debate on the approximation process or the EnCT membership bid and their interests and visions are taken on board.[591] However, since both companies are 100% owned by the Georgian Ministry of Energy, their interests could be assumed to be aligned or at least internalised by the decisions taken by the Ministry.

Moreover, multi-national and third-country national energy companies active in Georgian gas sector are important stakeholders, too. Among these, Azeri SOCAR would be affected by the distribution level reforms, while the South Caucasus Pipeline Company[592] by the transmission/transit level reforms in Georgia's natural gas sector. Nevertheless, none of these stakeholders have formal veto-powers with regard to the legislative approximation process in Georgia[593] and have not even been part of the internal debate process.[594] However, it is important to note that, some of these companies (especially SOCAR) are state-owned and their operation in Georgia are guaranteed at the bilateral intergovernmental level.[595]

Indeed, following the announcement by the Georgian government of its desire to join the Energy Community Treaty, the Azerbaijani Foreign Ministry indicated that, it would not raise issues relating to this membership. However, it hinted its expectation that, *"it's very unlikely that the third energy package of [the] EU in its most strict form would be applied to*

[589] Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

[590] Interview with an official from the Georgian Ministry of Energy, 03/06/2015, Brussels.

[591] Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

[592] The SCPC is the owner and the operator of the SCPx (the first leg of the SGC) and its shareholders are: BP, operator (28.8%), SOCAR (16.7%), Petronas (15.5%), Lukoil (10%), NICO (10%) and TPAO (19%).

[593] Interview with a senior Georgian diplomat, who was a party to the EU-Georgia AA negotiations, 16/04/2015, Brussels.

[594] Interview with an official from SOCAR Georgia Gas, 21/04/2015, Tbilisi.

[595] Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

the pipelines Baku-Tbilisi-Ceyhan, Baku-Tbilisi-Erzurum (SCP) or future TANAP."[596] Otherwise, Azerbaijan, or rather the consortium operating the SCPx, would be required to reserve up to 50% of the capacity of the pipeline *"for some mythical oil and gas of the third parties",*[597] in order to comply with third-party access rules prescribed under the EU rules. This, consequently, would mean that Azerbaijan (or rather the consortium operating the SCPx) would have to facilitate the access of its competitors (e.g. Turkmenistan) to the pipelines under its control. Therefore, it can be expected that, although they do not yield formal veto powers, they would nevertheless be involved in the negotiations with the Georgian government when and if the latter takes a decision to go ahead with the legislative approximation.[598]

3. Main findings and implications on the SGC

As I argued above, the export of the EU energy *acquis* to the partner countries is one of the core aims of the Eastern Partnership established in 2009,[599] which the EU pursues in tight synergy with its Southern Gas Corridor strategy. In doing so, the bilateral track of the EaP uses the *more-for-more* principle as an external incentive to foster approximation of the partner counties', in our case Georgia's energy legislation with the EU *acquis*. If successful this would have the potential to eliminate transit risks to energy supply via the SGC by absorbing Georgia into the regulatory sphere of the EU single market. Nonetheless, as this chapter analysed in detail, Georgia as a vital transit country along the SGC, has not implemented the EU natural gas legislation domestically and has little incentive to do so in the foreseeable future. As such, this has implications on both, the EaP as a tool of external (energy) policy action of the EU, as well as the competitiveness of natural gas supply to the EU via the SGC.

3.1. EaP and Europeanisation of Georgia's natural gas sector

Despite Georgia's EU membership aspirations and its contractual (legal) commitment to approximate domestic energy legislation with the EU *acquis* as part of the EU-Georgia Association Agreement, rule adoption in the country is currently hindered by the expectations of the certain domestic costs. Georgian government is concerned about the

596 'Azerbaijan Not to Raise Questions Regarding Georgia's Entry into EU Energy Community'.
597 'Azerbaijan Not to Raise Questions Regarding Georgia's Entry into EU Energy Community'.
598 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.
599 Michael Ratner and others, *Europe's Energy Security: Options and Challenges to Natural Gas Supply Diversification* (Congressional Research Service, 2012), p. 3.

impact of the EU *acquis* on the transit benefits and cheap domestic gas that the government currently enjoys without bringing about comparable benefits in natural gas sector in specific or in attainment of the EU candidate status in general. Therefore, in order to minimise the economic and energy security costs of rule adoption, the government intends to tailor the depth and timeline of the implementation process to the necessity of receiving these benefits for a considerable period of time.

Hence, in line with the rationalist analysis, domestic constraints (net adoption costs) serve as a pivotal factor underpinning the decision of Georgia in rejecting the EU rules. These costs come about when the material preferences of the target country are being confronted with the new institutional milieu, which entails more costs than benefits in return. This, consequently, leads to an outcome where the adoption or the implementation of the formal institutions by the target countries is deemed prohibitively costly and hence, irrational, as predicted by the External Incentive Model.

Nonetheless, the impact of the net adoption costs in rule adoption must be viewed in the context of the promised reward, for the role of the reward is not *ideational* but *material*. The promised reward in return for rule adoption carries out the function of augmenting the benefits against the costs. That is to say, although the costs are assumed to be pre-given, as they are underpinned by the exogenous preference formation of the actor (Georgia) in question (to be able to benefit from energy transit and purchase benefits), their weight can be rendered smaller vis-à-vis the prospective benefits. In practical terms, this would require the EU to offer the EaP countries a bigger reward in order to tip the scale of the cost-and-benefit nexus in favour of the latter. Hence, in support of the explanatory argument of this thesis, *net adoption costs* play a decisive role in rule adoption in the context of lack of *membership prospects.* Since the EaP does not envisage membership prospects or any comparable energy-specific benefits for the partner countries involved, its contractual outcome - AAs, have few chances to succeed in the expansion of energy sector-specific market rules externally.

3.2. Failure of rule adoption and the competitive EU gas supply via the SGC

Against the backdrop of the failure of Europeanisation of Georgia's natural gas sector, the transportation/transit of Caspian Basin natural gas through this country will continue to be subject to political and economic bargaining between the Georgian government and the relevant public and private actors involved in the SGC. This, in turn, renders the supply of energy across Georgia *uncompetitive*. As I have argued in Chapter I, *competitiveness* of energy supply is expressed in the *affordable* price formation of the energy offered in the

consumer markets, which is not affected by the factors unrelated to the changes in global/regional supply and demand balance.[600] In other words, under *competitive* market conditions the transit of Caspian energy to the EU consumers must not be affected by or linked to Georgia's interests in having cheaper domestic gas prices or the attainment of additional fees in return for providing the *freedom of transit* across its territory as envisaged by the EU natural gas market rules. Nonetheless, the detrimental impact of the failure of Europeanisation of Georgia on the *competitiveness* of gas supply via the SGC can be expected to be less *intrusive* as compared to Turkey. This is supported by two factors.

Firstly, unlike Turkey, successive Georgian governments have been pursuing less aggressive energy diplomacy vis-à-vis its neighbours. In this context, Georgia has never aspired to play the role of a middleman in the transportation of Caspian hydrocarbon resources to the Western/world markets - buying Caspian gas in cheap and re-selling it to the Western consumers more expensively. They have only satisfied with transit benefits and cheap gas volumes that they have been receiving from the neighbouring producers, which I have argued are nevertheless substantial. Furthermore, it does not control the transit pipelines traversing its territory, hence, its *day-to-day* political and economic interference to the gas transit across its territory is minimal.

Secondly, even though Georgia is still an important component of the SGC, from the EU perspective, the application of the EU energy acquis in Georgia would only make considerable difference if Turkey were also to apply the energy *acquis*. Otherwise, the Europeanisation of Georgia alone would make the country an island surrounded by non-EU regulatory regimes, as there are no direct linkages between the Georgian and the EU market(s).[601] Thus, energy Europeanisation of Georgia would be less relevant if Turkey (and Azerbaijan) were not to be Europeanised at the same time.

This is true not only from the *competitiveness* point of view, but also from the perspective of *diversity* of supplies via the Georgian section of the Southern Gas Corridor. The country plays a transit role for gas supplies originating from the Caspian Basin only through the territory of neighbouring Azerbaijan. In this vein, if non-Azeri gas volumes (e.g. from Central Asian countries such as Turkmenistan or Uzbekistan) were to be shipped to the

600 Escribano and García-Verdugo, 'Energy Security, Energy Corridors and the Geopolitical Context: A Conceptual Approach', p. 27.

601 This point was highlighted during one of my elite interviews with a key DG Energy/EC official who did not authorise me to use attributable quotes, 03/05/2015. Furthermore, in his speech during a High Level Reflection Group conference at the European Parliament on 20/03/2014, in which I took part as a passive observer, the former EU Energy Commissioner, Günther Oettinger also underlined this curious fact that "Georgia will become the first Contracting Party without being physically interconnected - neither for electricity, nor for gas - with any of Energy Community Parties - Günther Oettinger, 'Speech: An Energy Community for the Future', 2014 <http://europa.eu/rapid/press-release_SPEECH-14-238_en.htm> [accessed 24 March 2014].

European markets via the SGC using a trans-Caspian link, then they would have to negotiate their pipeline access rights in Azerbaijan first. The latter, as I will investigate in the following chapter, however, lies beyond the regulatory sphere of the EU *acquis* and unlike Georgia, has not even committed itself to any regulatory approximation with the EU rules. Therefore, the success of Europeanisation of Georgia would make a sizeable difference for the *competitive* and *diverse* supply of energy via the SGC only if similar rule adoption processes were to take place in Turkey and Azerbaijan, too.

In the next, final chapter of this thesis I investigate the outcome of Europeanisation of Azerbaijan's natural gas sector in order to present the complete results of the regulatory dimension of the SGC and the potential of market-based EU natural gas supply via it.

CHAPTER VI: EUROPEANISATION OF AZERBAIJAN's NATURAL GAS SECTOR & SGC

1. Introduction

The role of Azerbaijan in the development and the functioning of the Southern Gas Corridor is central, for the country will serve not only as a supply source for this alternative energy corridor but also as a transit route between the Central Asian and the EU. From the perspective of the market-based governance of the SGC, this dual role of Azerbaijan presents certain transit risks to the functioning of the SGC. These transit risks can take the form of restrictions of access to transit capacity across the country for political and/or commercial reasons, as well as excessive charges for the prospective transit of Central Asian natural gas to the European markets. As I will illustrate in this chapter, these transit risks have in the past derailed the development of a Trans-Caspian Pipeline, which was initially slated to supply Central Asian gas to the Turkish and later to the European markets.

For these reasons, given that supply of Central Asian gas to the EU is an integral part of the original SGC blueprint of the EU, Azerbaijan has been a target of the EU external energy governance strategies ever since the start of industrial scale gas production in this country in the early 2000s. This effort of external Europeanisation of Azerbaijan has been pursued by the EU through the bilateral EU-Azerbaijan Memorandum of Understanding in Energy, Eastern Partnership, as well as the multilateral initiatives, such as Baku Process and Energy Community Treaty. Similar to Georgia, the mode of the external EU governance vis-à-vis Azerbaijan is under the membership line. Even more, unlike Georgia Azerbaijan has not even expressed its desire to become a member of the EU anytime soon. Therefore, the nature of relations between Azerbaijan on the one hand and the EU on the other is less asymmetrical than the one between the EU and Turkey or even Georgia.

Nonetheless, Azerbaijan has been included into the EaP, which envisages some incentives for the Eastern partners in return to their adoption of the EU *acquis*, including the EU legislation in natural gas sector. As I have argued in Chapter III, although the nature and the size of these incentives offered are much inferior compared to the accession process (association vs. membership), the EaP envisaged similar level of reforms to be carried out by the partner countries, including Azerbaijan. With these in mind, it is the aim of this

chapter to investigate the application of the EU Third Energy Package in Azerbaijan and analyse the role of the domestic costs in affecting this rule adoption process.

As I argued in the previous chapters, this PhD takes advantage of the conceptual and theoretical tools from the Europeanisation literature in order to reveal and analyse the factors that will potentially affect the functioning of the Southern Gas Corridor as an alternative energy supply corridor to the European Union. Consequently, this will enable me to investigate the contribution of the SGC to the EU's conception of energy security, which includes both the *diversity* and *competitiveness* of energy supply

With this in mind, below I first provide the description of the level of legislative approximation between Azerbaijan and the EU in natural gas sector. Then, I set out to provide a thick analysis of the domestic factors in Azerbaijan that brought about the current state of outcome in rule adoption process. Finally, I assess these findings in the context of natural gas supply across the Azerbaijani segment of the SGC and its potential implications on the competitive gas supply to the EU via this corridor.

2. Europeanisation of the natural gas sector of Azerbaijan

The institutionalisation of the bilateral relations has been one of the top priorities of the EU vis-à-vis this small Caspian country, not least due to the rich energy resources that it is naturally blessed with. Although for years the EU policy lacked strategic coherence in its relations with Azerbaijan[602] (and other Caspian hydrocarbon producers), its preferred external engagement tool, namely, external governance has been rather systematic in relation to this country.

Since the start of the development of hydrocarbon resources in Azerbaijan in the mid-1990's, the export of the EU rules has been at the centre of the EU-Azerbaijan bilateral and multilateral interaction. At the bilateral level, the basis of the EU-Azerbaijan energy cooperation was the *"Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy"* signed in 2006.

The MoU stated that, *"the gradual harmonisation by Azerbaijan to the EU energy acquis would constitute a significant step towards Azerbaijan's objective of gradual economic integration and deepening of political cooperation with the EU".*[603] In this regard, the

[602] See e.g. Christie, Lussac and Wolczuk, *The EU and Its Eastern Partners: Energy Needs and Future Prospects*; Lussac, 'Ensuring European Energy Security in Russian "Near Abroad": The Case of the South Caucasus'.

[603] 'Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy', p. 2.

document declared that, *"[t]he gradual convergence with the EU's internal energy market, aiming ultimately at its integration, remains a shared priority for the EU and Azerbaijan"*.[604] Although at the time of signature, the EU energy *acquis* was less stringent, the MoU, nevertheless, outlined structural reforms inter alia in the spheres of *unbundling* of Azerbaijani gas (and electricity) transportation systems from supply activities,[605] as well as ensuring the establishment of safe and secure transit systems across Azerbaijan in order to facilitate the potential exports of the Central Asian gas resources to the EU.[606] The MoU has since become the primary document underpinning bilateral cooperation in energy sphere, which had been institutionalised under "The Energy and Transport Sub-committee", set up within the framework of the EU-Azerbaijan Partnership and Cooperation Agreement (PCA).

In support of the MoU and the implementation of the PCA, Azerbaijani Ministry of Energy later concluded a Twinning Contract on the *"Legal Approximation and Structural Reform in the Energy Sector of Azerbaijan"* with the German Federal Ministry of Economics and Technology (BMWi),[607] which aimed at providing legal and technical assistance to Azerbaijan in preparing legislative reforms in natural gas sector.

Furthermore, following the establishment of the EaP in 2009, the EU embarked on a much denser institutional interaction with Azerbaijan with a view to signing an Association Agreement and deepen the economic integration and political association between the parties. Although Azerbaijan never signed an AA with the EU, bilateral energy dialogue under the Eastern Partnership can still be considered as the pinnacle of the EU's efforts to export its domestic natural gas legislation to this country. This took place during the time when the energy supply prospects from the Caspian Basin to the EU has entered a new stage with the establishment of the Southern Gas Corridor.

Against this backdrop, despite the existence of multiple projects aimed at rule export, however, regulatory developments in Azerbaijani energy sectors have not matched the speed of the construction of the (oil and) gas export pipelines towards the European markets. The energy sector in Azerbaijan, including natural gas, is entirely regulated by two laws: Law on Gas Supply (30 June 1998) and Law on Energy (24 November 1998). From the regulatory point of view, the Ministry of Energy is responsible for issuing

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[604] 'Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy', p. 4.

[605] 'Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy', p. 7.

[606] 'Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy', p. 8.

[607] Sandtner, *Twinning Project: Legal Approximation and Structural Reform in the Energy Sector of Azerbaijan*.

licenses for special gas supply activities and the Ministry of Emergency Situations of Azerbaijan Republic is in charge of issuing licenses for the installation and operation of natural gas infrastructure.[608] According to the Law on Natural Monopolies, the state recognises the existence of natural monopolies in the country, which include infrastructure for the transportation, distribution and storage of natural gas.[609]

Firstly, the Law on Gas Supply (30 June 1998) does not differentiate between gas *network* and *supply* activities and does not prescribe *unbundling* - separation of ownership of gas transportation/distribution entities from the supply undertakings.[610] Within this legislative framework, the State Oil Company of Azerbaijan Republic (SOCAR) acts as the monopolist of the entire gas transportation and distribution networks and storage infrastructure in Azerbaijan through its Azerigaz subsidiary. The latter is wholly owned by SOCAR under the Presidential Decree No. 366 dated July 1, 2009.[611] Accordingly, Azerigaz carries out all the transportation, distribution and sales of natural gas in the territory of Azerbaijan on its own or through its regional divisions.[612] In addition to owning and operating the transmission and distribution pipelines through Azerigaz, SOCAR is also involved in the exploration and production of natural gas in onshore and offshore Azerbaijan, both on its own and through the production sharing agreements (PSA) it has signed with international oil majors. In this regard, the company is considered a *vertically integrated undertaking* (VIU), which is prohibited under the EU law. Other gas producers (consortia) are not allowed to directly sell gas to the Azeri domestic consumers, as the market is not liberalised.[613]

Secondly, although third-party access to the transmission and distribution networks is allowed under the Law on Energy and Law on Gas Supply, there is no guaranteed (regulated) TPA regime in line with the EU legislation. Third parties must negotiate their access contracts with the pipeline operators, which then have to be endorsed by the

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608 *Azerbaijan: Follow-up in-Depth Review of the Investment Climate and Market Structure in the Energy Sector* (Energy Charter Secretariat, 2011), pp. 66–69; Kamil Valiyev, *Presentation on the Overview of Gas Market Regulation in Azerbaijan* (SOCAR, Legal Department, 2010).

609 'The Law of the Azerbaijan Republic On Natural Monopolies' (Azerbaijan, 1998), Article 5.

610 'The Law of the Republic of Azerbaijan "On Gas Supply", N 513-IG' (Azerbaijan, 1998), Chapter I; see also, *INOGATE Programme: Status Report 2011*, p. 12; Valiyev, *Presentation on the Overview of Gas Market Regulation in Azerbaijan*.

611 'Decree No. 366 of the President of the Republic of Azerbaijan "Concerning Improvements in Petroleum Industry Management Systems"', 2009; see also, Shahin Abbasov, 'Azerbaijan: For SOCAR, Bigger Means Better with Azerigaz Takeover', *EurasiaNet*, 26 July 2009 <http://www.eurasianet.org/departments/insightb/articles/eav072709a.shtml> [accessed 28 February 2014].

612 *Azerbaijan: Follow-up in-Depth Review of the Investment Climate and Market Structure in the Energy Sector*, pp. 67–68.

613 *Azerbaijan: Follow-up in-Depth Review of the Investment Climate and Market Structure in the Energy Sector*, p. 68.

competent state authority.[614] This allows the pipeline owner (SOCAR), as well as the Ministry of Economy (as a national competent authority)[615] the right to refuse third-party access to the transmission/transit lines. Tariffs, on the other hand, are proposed by the pipeline operator and approved by the Tariff Council under the Ministry of Economy.[616]

National transmission lines are used not only for domestic gas delivery, but also for exports to Georgia, Iran and Russia.[617] Therefore, from the point of view of cross-border gas transportation, they have transit value, both for the immediate neighbours, as well as the big consumers like the European Union.

Last but not least, Azerbaijan is the host for the major transit pipeline - South Caucasus Pipeline (and its expansion version dubbed SCPx), which constitutes the first leg of the current design of the Southern Gas Corridor. The pipeline has its own access regimes, which does not envisage regulated TPA and unbundling mechanisms. BP owns the majority of the shares and operates the pipeline under the Host-Government Agreement, while the rest of the shares belong to the international energy companies, which are members of the consortium producing gas in Shah-Deniz field. Therefore, not only the national transmission lines, but also the specialised export infrastructure are not in compliance with the principles of the EU *acquis*.

In the context of the EU-Azerbaijan MoU, the Azerbaijani government has prepared 4 draft laws on natural in order to harmonise the Azerbaijani natural gas market structure with the EU model. However, in spite of considerable work, as well as the mounting pressure from the European Union,[618] none of these drafts were (or expected to be) adopted by Azerbaijani national parliament (Milli Majlis) and have been shelved ever since.[619] This begs questions with regard to the factors that underpin the lack of political will in Azerbaijan in adopting the EU rules.

In general, the Azerbaijani government has always been keen on cherry-picking the offered EU legislation on *à la carte* fashion, while ignoring those which do not meet its

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614 *Azerbaijan: Follow-up in-Depth Review of the Investment Climate and Market Structure in the Energy Sector*, p. 68; 'The Law of the Republic of Azerbaijan "On Gas Supply", N 513-IG', Article 12.

615 'Regulations of the Ministry of Economic Development of the Azerbaijan Republic, Addendum II Approved by Decree No.504 of the President of the Azerbaijan Republic Dated 28 December 2006' (Azerbaijan, 2006) <http://economy.gov.az/index.php?option=com_content&view=article&id=8&Itemid=122&lang=en> [accessed 24 February 2014], Articles 3.1.15 and 3.1.80.

616 *Azerbaijan: Follow-up in-Depth Review of the Investment Climate and Market Structure in the Energy Sector*, p. 12.

617 Interview with an official from SOCAR Georgia Gas, 21/04/2015.

618 This was personally observed by the author during the attendance of the 13th meeting of the Platform 3 on Energy Security, June 19, 2015, Brussels.

619 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

national/elite interests.[620] The natural gas sector is especially sensitive in this regard. Unlike oil, which is important mostly for commercial reasons, international gas trade is inseparably intertwined with (geo)politics and can bring strategic, as well as economic dividends for the country. Thus, it is quite unsurprising what the president of Azerbaijan, Ilham Aliyev meant by "Oil is all about business, while gas is about politics".[621]

In order to analyse the domestic factors, which condition the failure of rule adoption in Azerbaijan, I utilise External Incentive Model as a rationalist explanation of policy choices pursued by the government. This model predicts that, "*A government adopts the EU rules if the benefits of EU rewards exceed the domestic adoption costs*".[622] With this in mind, the following sub-sections analyse the role of *size and speed of reward, credibility of conditionality* and *the net domestic costs & veto holders* in the failure of the EU-sourced energy reforms in Azerbaijan.

2.1. Size and speed of final reward: strategic vs. normative partnership

In general, the Azerbaijani government has not spared an occasion to define and reiterate its notion of *closer cooperation* with the EU and its expectations towards the EU in fulfilling this vision. In this regard, from the government's viewpoint, Azerbaijan is interested in a *strategic* partnership with the EU, as opposed to a *normative* one.[623] This, inter alia, includes the recognition of territorial integrity of Azerbaijan by the EU, as well as using the EU's political weight and financial support to foster the realisation of the strategic regional energy infrastructure. The latter shall enable Azerbaijan to become an alternative energy source, as well as transit route for the Caspian hydrocarbon exports to the EU and the world markets.[624]

In this regard, in the vision of the government of Azerbaijan, the *finalité* of the bilateral partnership should be based on the *in-kind* support for the mutual energy and security interests without engaging in *rules/values-based* interaction. As far as the Southern Gas Corridor is concerned, in practice this vision translates into political and financial support of the EU to the realisation of the SCPx, TANAP and TAP pipelines in return for new gas supplies that will contribute to the energy security of the European Union.

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620 Rashad Shirinov, 'A Pragmatic Area for Cooperation: Azerbaijan and the EU', *Internationale Politik Und Gesellschaft*, 2011.

621 Interview with an official from the EC/ DG Energy, 03/05/2013, Brussels.

622 Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 12.

623 Interview with Douglas Carpenter, EEAS, 16/05/2013, Brussels.

624 Interviews with the officials from Mission of Azerbaijan to the EU, 03/05/2013, Brussels and the State Oil Company of Azerbaijan Republic 29/06/2015, Brussels.

In terms of the institutionalisation of the bilateral interaction, the Azerbaijani government voiced its preference for a *Partnership for Modernisation (PfM)* agreement, as opposed to an Association Agreement, let alone for the eventual EU membership.[625] The PfM is *"typically understood as technological modernisation and EU financial assistance – for example, in infrastructural investments and so on – and not as reforms leading to liberal democracy".*[626] This excludes any binding commitment on the part of the Azerbaijani government to approximate its domestic legislation, inter alia, in natural gas sector with the EU *acquis*.

Hence, as far the external incentive model is concerned, I have already argued above that, the EaP lacks sizeable ultimate reward to incentivise costly domestic reforms in the partner countries. However, in the case of Azerbaijan, the government is interested neither in the Association with, nor even in the ultimate membership in the EU. Although the bilateral negotiations on the AA were lunched in 2012, Azerbaijan ultimately decided not to pursue this avenue, mindful of the dense reforms agenda envisaged therein. This diminishes the EU's capacity to encourage reforms in Azerbaijan, including those affecting the Southern Gas Corridor and renders the size and/or speed of the final reward an irrelevant factor in fostering rule adoption in Azerbaijan.

2.2. Credibility of conditionality and reversed asymmetric interdependence

Since the AA or the ultimate EU membership prospect is not the driving force behind EU-Azerbaijan cooperation, *credibility of conditionality* does not determine the strategic actions taken or avoided by the Azerbaijani government in its energy reform agenda.

Nonetheless, the access to the EU's gas market could be regarded as a potential reward in return for the domestic reforms in Azerbaijan, which in turn would ensure safe, secure and economically viable transit of Central Asian gas across this country (especially considering that gas reserves in Central Asia far outstrips those in Azerbaijan). Although from the international trade point of view, this access cannot entail any preferential customs treatment of Azerbaijani gas, for the country is not a member of the WTO and is not eligible for a DCFTA with the EU.[627] Despite this, the EU has been keen on providing political, technical and financial support to the SGC through its Projects of Common Interest (PCI) programme and high level political engagement with different actors along this corridor. Continuation of this support in return for domestic reforms in Azerbaijan

[625] Rettman, 'Azerbaijan and EU Race to Agree "Modernisation" Pact'.
[626] Grzegorz Gromadzki, 'An Urgent Challenge for Today's Europe: The Eastern Partnership', *Internationale Politik Und Gesellschaft*, 2011, pp. 11–28 (p. 19).
[627] 'Eastern Partnership COM(2008) 823', p. 4.

could be, in principle, used as a form of conditionality in (natural gas) sectoral cooperation.

However, such an expectation disregards the unique asymmetrical dependence in EU-Azerbaijan bilateral relations, compared to other EaP countries. In Georgia, Moldova and Ukraine, the physical and regulatory integration of the energy markets with the EU is strategically beneficial both for the donor (EU), as well as the recipients (EaP countries). From the perspective of the EU, *acquis* will reduce transit risks across these countries, while from the perspective of the EaP countries, the EU rules will facilitate their access to the EU energy markets as an energy importers. For example, following the Russia-Ukraine political and ensuing gas crisis in 2014, Ukraine was able to cover substantial share of its domestic demand using the reverse-flow gas imports from the EU itself.[628] The application of the EU's energy market rules in establishing this reverse flow capacity ensured that no non-market hurdles impinge upon the supplies to Ukraine from the West.[629] In other words, from the Ukrainian perspective, the application of the EU rules is not only a legal commitment under the EU-Ukraine AA, but also a resource that can be and is currently utilised to ensure the country's energy supply security.

However, the case with Azerbaijan is entirely different. Not only it does not depend on external gas imports, it in fact acts as a vital alternative gas supplier to the EU. This results in the reversal of the asymmetrical relationship between the EU and Azerbaijan, where *"Azerbaijan positions itself as a donor and sees the EU as being on the receiving end of the equation".*[630] Through its state-owned company SOCAR, the Azerbaijan has assumed the role of the *enabler* of this alternative energy corridor by providing the initial gas volumes, as well as investing in the necessary transit pipelines.

Aware of the high stakes that the EU has placed on the SGC, the Azeri government does not only show *resource-based reluctance* to implement the EU *acquis* envisioned under the existing mechanisms or sign up for new ones under the EaP umbrella. It is also well positioned to change the agenda of the bilateral negotiations to suit its own strategic goals, as opposed to the regulatory agenda of the EU.

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628 Roman Olearchyk, 'Gas: Ukraine Looks West to Curb Reliance on Russia', *Financial Times*, 18 October 2013 <http://www.ft.com/cms/s/0/d6922826-3286-11e3-91d2-00144feab7de.html#axzz2tV3x1lmP> [accessed 16 February 2014]; 'EU Reverse Gas Flow Capacity to Ukraine to Rise to 40 Mcm/day', *Reuters*, 23 January 2015 <http://www.reuters.com/article/2015/01/23/us-eu-energy-ukraine-idUSKBN0KW12A20150123> [accessed 15 May 2015].

629 'Reverse-Flow Woes', *The Economist*, 5 November 2013 <http://www.economist.com/blogs/schumpeter/2013/11/gazprom> [accessed 16 February 2014].

630 Anja Franke and others, 'The European Union's Relations with Ukraine and Azerbaijan', *Post-Soviet Affairs*, 26.2 (2010), 149–83 (p. 163).

Increasing oil rents have played an important role in switching the donor-acceptor ends of the EU-Azerbaijan relationships. The country is not in desperate need of foreign investment anymore.[631] Hence, since the start of Azeri oil exports to the world markets, the government is more self-reliant than ever and commands a bigger scope for manoeuvre in determining the conditions of its hydrocarbon exports in the second phase[632] of their development. Especially considering that, the Azeri government places political importance to its natural gas export strategy,[633] it can be expected that, the current leadership will unlikely sign up and carry out reforms that may endanger the country's (geo)political and economic position in the future.

In this regard, in the absence of the EU membership aspirations, more advantageous negotiations position may explain the Azeri government's ability to resist against the EU pressure to approximate its domestic energy legislation with the EU *acquis*. However, as it was the case with Georgia, they do not necessarily explain the underlying factors that condition the government's decision to not to carry out legislation approximation.

Some experts have pointed out to the lack of the recognition of the territorial integrity of Azerbaijan in the AA as the underlying reason of the Azeri government's reluctance to sign one. The draft AA that were to be signed with Azerbaijan lacked unambiguous language as regards the EU's recognition of the territorial integrity of Azerbaijan in the same way as it does other EaP countries, namely, Georgia and Moldova. In itself, this and other similar factors may explain the general political reluctance of Azerbaijani government to sign an Association Agreement with the European Union. Nevertheless, the lack of firm EU recognition of Azerbaijani territorial integrity does not necessarily explain the underlying reasons of the failure of Azerbaijan to approximate to the EU *acquis* through other avenues of bilateral cooperation, like the "*Memorandum of Understanding on a Strategic Partnership Between the European Union and the Republic of Azerbaijan in the Field of Energy*" and relevant bilateral *Twinning* projects, as well as the regional multilateral instruments such as the *Baku Process* and *INOGATE* technical assistance. Unlike the

631 Shaffer, 'Caspian Energy Phase II: Beyond 2005'.

632 The first wave of the PSAs between Azerbaijan and the international oil majors were signed in the mid-and-late 1990s. For example, the PSA on the giant Shah-Deniz field was signed in 1996 and the field started the first gas exports in 2006. This PSA covered only the first phase of the development of the mentioned field. In this phase, BP acted as the technical and production operator of the field development, while both BP and Norwegian Statoil lead negotiations on the sales of Shah-Deniz gas to Turkey. In 2013, the Shah-Deniz stakeholders made a final investment decision (FID) on the development of the second phase of the development of Shah Deniz field. However, in this latter phase, the commercial negotiations regarding the marketing of the produced gas was lead by an ad hoc team of negotiators, while the gas is sold by the newly established Azerbaijani Gas Sales Company (AGSC). As opposed to the first phase, Azerbaijani SOCAR took a leading role during the SD II gas sales negotiations and currently owns the biggest number of shares in the AGSC.

633 Quoted by an EC/DG Energy official during the elite-interviews, 03/05/2013, Brussels.

Association Agreement, none of this bilateral and multilateral avenues of the EU external governance include overall political or security aspects of the EU-Azerbaijan cooperation. Hence, the reluctance of Azerbaijani authorities to not to approximate its domestic energy legislation with the EU *acquis* cannot be objectively explained by the government's scepticism about the EU's lack of interest in Azerbaijan's (hard) security concerns.

Furthermore, the keen interest of Azerbaijani authorities in the EU experience in renewable electricity generation and considerable progress in that regard[634] justifies further analysis into the failure of rule adoption in the natural gas sector. Quite interestingly, the latter also allows us to account for the legitimacy argument in the process of rule adoption, which is predicted by the Social Learning Model of external Europeanisation.[635] If the major concern of Azeri authorities in rejecting the EU rules were conditioned by external imposition and overall legitimacy of this process, then this policy behaviour should also have been observed in the renewables (and in general electricity) sector, too, which is not the case.

Last but not least, Azerbaijani officials who take part in the Euronest energy committee also indicated reluctance to recognise the merits of the EU energy *acquis*. This multilateral instrument of cooperation under the EaP is designed to ensure parliamentary oversight over the bilateral cooperation between the EU and Eastern Partnership countries and provide legitimacy to the cooperation process through the socialisation of the national and European parliamentarians. In this multilateral avenue, too, the legitimacy of the EU rules were not called into questions, while the reluctance of the rule adoption were justified by the potential domestic costs of the partner countries, especially, Azerbaijan Republic.[636]

In order to unearth these very factors, therefore, it is necessary analyse the net domestic costs that EU *acquis* would incur in Azerbaijan in return for limited benefits that could be

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634 The Azeri government has adopted *"The State Program on Utilization of Alternative Energy Sources (2005 – 2013)"* and established the State Agency on Renewable Energy Sources (SAARES). According to the former, a target of 20% has been set for the share of RES in electricity production, as well as 9.7 in total energy consumption by 2020. See e.g. 'Technological Action Plan (TAP) For Mitigation Technologies' (The Ministry Of Ecology And Natural Resources, 2012), p. 5 <http://unfccc.int/ttclear/sunsetcms/storage/contents/stored-file-20130327152334804/TechnologicalActionPlan-Mitigation_Azerbaijan.pdf> [accessed 29 December 2013]. According to the deputy Chairman Jamil Malikov, the main aim of the State Agency is to increase the share RES up to 20% of energy production by 2020 *"in accordance with the requirements of European Union. […] Tariff policy will be based on the subsidies of the government. Investments will be stimulated and several concessions will be provided to producer companies"* – see 'Gobustan to Meet Its Demand for Energy from Alternative Energy Sources from 2015', *APA Information Agency*, 2013 <http://en.apa.az/news/202060> [accessed 29 December 2013].

635 Schimmelfennig and Sedelmeier, 'Introduction: Conceptualizing the Europeanization of Central and Eastern Europe', p. 18.

636 The author observed this debate, which took place during the sixth meeting of the Committee on Energy Security of the Euronest Parliamentary Assembly, 12 February 2013, Baku.

expected from the approximation process. I analyse these domestic factors in the next section.

2.3. Net adoption costs and the veto holders

In the run up to the Vilnius summit of the EaP on 28-29 November the Head of the Foreign Relations Department of the Azerbaijani Presidential Administration Novruz Mammadov remarked that, *"We have informed the European Union a year ago that we cannot accept the Association Agreement. We want to prepare a document which more adequately meets the level of our relations with the European Union"*. He further explained that such a document is to *"reflect the level of bilateral cooperation and provide mutual respect and equality of the parties"*.[637]

This statement came at a time, when officials in Brussels have long been frustrated by the indecisive progress made by Azerbaijan in its integration with the European Union. This includes not only the failure of the Azerbaijani state authorities to take on new political commitments under the EaP,[638] but also to fulfil those that have already been committed to under the EU-Azerbaijan Partnership and Cooperation Agreement, as well as through membership in other international organisations.

2.3.1. Net adoption costs

According to the Action Plan 2011-2015, approved by the President for the implementation of the State Program on Poverty Reduction and Sustainable Development 2008-2015, the state was expected to start the privatisation of the certain enterprises in energy sector.[639] Although the timeline of the implementation of the programme nears to the end, no concrete actions have been taken in this direction and no immediate plans exist to open up state energy companies and domestic market to private capital.[640] Quite the opposite, during the meeting of the energy security committee of the EURONEST Parliamentary Assembly the Depute Speaker of Milli Majlis (Azerbaijani Parliament) Valeh Alasgarov retorted to the call of the MEP Gerben Yan Gerbrandi to liberalise Azeri energy

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637 'Novruz Mammadov: We Offer EU Bilateral Agreement for a Long Time', *Contact.az*, 2013 <http://www.contact.az/docs/2013/Politics/112500058907en.htm#.Ur7SFGRdU00> [accessed 28 December 2013].

638 Rettman, 'Azerbaijan and EU Race to Agree "Modernisation" Pact'.

639 'Decree No. 3043 of the President of the Republic of Azerbaijan on "State Program on Poverty Reduction and Sustainable Development 2008-2015"', 2008.

640 'In-Depth Review of the Energy Efficiency Policy of Azerbaijan' (Energy Charter Secretariat, 2013), p. 46.

sector, by arguing that privatisation and liberalisation of state energy enterprises will reduce the government's income by 25%.[641]

Thus, it is necessary to investigate the net adoption costs and the potential role of the domestic veto players in order to unearth the underlying reasons of the failure of rule adoption in Azerbaijan. As I illustrated above, the government has the full control over the domestic gas market by exercising monopoly rights over the domestic wholesale and retail markets, as well as the main transmission and distribution networks. This control creates a natural monopoly over the domestic gas transportation and distribution, which in turn allows the government to save the domestic gas market for monetising its own share of natural gas produced under the production sharing agreements (PCAs) in the country and keeping the other stakeholders of the PSAs off the domestic grid. In other words, this means legally monopolising the domestic gas supply and avoiding the competition.

If the government were to adopt the EU rules, it would have to liberalise the domestic gas market, *unbundle* supply and transmission activities of its national energy company and provide guaranteed *third party access* to all parties interesting in supplying domestic consumers and/or seeking access to cross-border transportation capacities. Consequently, this would result in losing the state's control over the energy networks and entail economic and strategic costs for the government.

According to the chief negotiator with the EU on energy policy at the Mission of Azerbaijan at the EU, Rashad Novruz, by applying EU rules Azerbaijan *"[would] be losing the ownership control over the resources, the means of distributing and transporting them [and] have anybody in the [domestic] market but [itself]"*.[642] In ratio to the size of population, domestic gas market in Azerbaijan is relatively large - with 11 bcm gas consumption per year; this provides considerable share of the state budget revenues. In this vein, according to the same state official, if the copy-pasted legislation were in place in Azerbaijan, it would be really hard, if not absolutely impossible to revise later on. Therefore, the government's concern is whether Azerbaijan needs the EU legislation *"at this stage of development [...] when the role of state in economy and energy is increasing?!"*.[643]

Azerbaijan is the only country among the EaP members that owns hydrocarbon resources and re-invests considerable amount of energy income back to the economy. The Azerbaijani economy is heavily reliant on oil and gas revenues, which make up circa 45% of the domestic GDP and over 70% of the country's fiscal revenues. Oil and gas sector also

641 This debate took place during the sixth meeting of the Committee on Energy Security of the Euronest Parliamentary Assembly, 12 February 2013, Baku.

642 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

643 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

accounts for 92% of the exports.[644] Investment into non-oil sector, especially construction, education, agricultural sectors, as well as infrastructure development, is mainly driven by public expenditures.

State budget in 2014 was envisaged to be around 20 bln AZN (Azeri MANAT), while 9 bln AZN being transferred from the State Oil Fund of Azerbaijan Republic (SOFAZ).[645] The SOFAZ is a sovereign fund of the country, which stores country's oil and gas revenues, excluding the taxation of the oil and gas companies operation in the country, which directly go into the state budget. These figures indicate that, more than half (around 70%) of the state budget is made of oil and gas revenues (i.e. oil and gas taxation + SOFAZ transfers) and the government cannot afford the reduction of the main source of the state revenues. This is especially when the state expenditures have become the main stimulant of broader economic (even if unsustainable) growth in the country.[646] Indeed, the Azeri government is conducting a social transfer program from SOFAZ, the main goal of which is to raise the minimum level of salaries and pensions in the county. Although not sustainable in the long-term, such a policy has decreased the level of poverty from 27% to just under 2%.[647] Hence, any reduction in state revenues would directly impact upon the short-term well-being of its citizens and might adversely affect the (already shaky) popularity of the current government.

The EU *acquis* was devised while having the interests of the consumer countries in mind, who are dependent on foreign gas imports and suppliers. Although EU member states receive tax revenues from the consumed gas, they do necessarily own these volumes. Conversely, Azerbaijan is a producer and net natural gas exporter; therefore, the factors that condition the structure of its domestic gas market are quite different from those of the EU. Natural gas is a pipeline bound fuel type and its transportation is extremely expensive due to its low density compared to, e.g. oil. Since Azerbaijan produces both oil and gas, it is economically better off to consume gas domestically, while exporting oil to international markets. However, given that it produces more gas than it needs domestically, the government prefers to reserve domestic market for the government's share of gas volumes and generate fiscal (and oil fund) revenues, while exporting the rest to the international markets. In this regard, as restructuring Azeri domestic gas market under

644 *Azerbaijan Republic, 2013 Article IV Consultation* (International Monetary Fund, 2013), p. 4.

645 'Azerbaijan State Budget Bill Envisages Revenues at AZN 18,384,000,000 for 2014', *News.az*, 10 October 2013 <http://news.az/mobile/articles/83374> [accessed 2 March 2014].

646 Zulfugar Agayev, 'S&P Sees First Azeri Deficit in Decade as BBB- Rating Affirmed', *Bloomberg*, 2 August 2013 <http://www.bloomberg.com/news/articles/2013-08-02/s-p-sees-first-azeri-deficit-in-decade-as-bbb-rating-affirmed> [accessed 2 March 2014].

647 Shahriyar Nasirov and Aitor Ciarreta, *Analysis of Azerbaijan Oil and Gas Sector* (Bilbao: ORKESTRA, Instituto Vasco de Competitividad, 2011), pp. 5–6.

the *EU design* would undermine this business model and entail financial and economic costs for the government, it is quite reasonable that the latter would be unwilling to let go of its sizeable revenues, in order to conform with the EU preferred market design.

However, the factors underpinning the failure of Europeanisation of Azeri gas sector are not limited to the potential loss of state revenues and are conditioned by the potential (*strategic and economic) opportunity costs*, as well. The latter are especially germane as far as the cross-border gas transportation in general and the Southern Gas Corridor in particular is concerned.

In this vein, in addition to its supplier status, Azerbaijan's geographical location allows the country to serve as a transit corridor for the potential Central Asian (Turkmen, Kazakh and Uzbek) gas exports to the EU and other European markets, while bypassing Russian territory. However, the role that Azerbaijan could potentially play on this issue would not be (only) that of a mere *geographical* transit corridor, but (also) that of a *transit player*, which (could) exercises control over the *economic*, *physical,* as well as the *political* terms of gas flow across its territory. In doing so, the government aims at prioritising the interests of its own hydrocarbon industry over those in Central Asia. This, in contrast with the EU *acquis*, conditions the ability of the Azeri government (and its upstream partners) to control the *access regime* and *transit conditions* to the pipeline within the Southern Gas Corridor.

To start with, priority access to the European gas markets has long been at the top of Azerbaijan's energy policy ever since the start of gas production in the country at the turn of the XXI century. This remained an issue of hard bargain also during the negotiations on the Southern Gas Corridor. For example, the construction of a pipeline across the Caspian Sea, which was to connect Turkmenistan with the European markets via the overland pipeline in Azerbaijan, Georgia and Turkey (i.e. SCP) was under consideration ever since the late 1990s and was supported by the USA and later on by the EU. The Azeri government at the time strongly supported the project in order to increase the geopolitical importance of the country for the West, especially against the backdrop of its territorial conflict with neighbouring Armenia. However, the discovery of a giant Shah-Deniz gas reserve in offshore Azerbaijan in 1999 changed the stakes and concomitantly the geo-economic strategy of the government. Following this discovery, the *"aggressive play"* of the Azeri government for gaining the share in the Turkish market stymied the US plans to foster the Trans-Caspian Pipeline (TCP) in order to deliver Turkmen gas to the Turkish

market.[648] To that end, the Azerbaijani government at the time ventured to increase the proposed transit fees for Turkmen gas, as well as to reserve the 75% of the South Caucasus Pipeline for its own gas; although prior to Shah-Deniz discovery it was ready to use the transportation capacity of the latter on equal terms with Turkmenistan.[649]

Admittedly, the maritime dispute between Azerbaijan and Turkmenistan over the ownership of the Kapaz/Sardar gas reservoir, which is located right on the expected maritime border between the countries (as well as Russian and Iranian opposition to the TCP), has also contributed to the disagreement and the postponement of the Trans-Caspian Pipeline (TCP). However, even if an agreement were to be reached on the shared development of the disputed gas reservoir, Azerbaijan would still have little incentive to promote the Turkmen gas transit across its territory at the expense of its own (prospective) market share in the European consumer markets.

In this context, it is important to note that Azeri gas reserves are not limited to Shah-Deniz only, which is slated to export 10 bcm/a to the EU markets via the Southern Gas Corridor starting from 2020. The offshore gas fields like Absheron, Umid, Babek, Shafag-Ashiman and Nakhchivan, which were discovered during the first decade of the XXI century, can in fact double or even triple Azeri gas export potential to the European markets.[650] Hence, it comes only naturally that Baku would rather prefer to commit most of its export/transit capacity for its own gas resources. Even the *"fraternal"* Turkish attempts to mediate between Azerbaijan and Turkmenistan were not successful if not annoying for the political establishment in Azerbaijan.[651]

Admittedly, this is not to say that the transit of Turkmen gas would only hurt the interests of Azerbaijani energy strategy. Quite the opposite, as I argued in Chapter II of this thesis, the scarcity of the initial export volumes from Azerbaijan ran the risk of making the Southern Gas Corridor commercially unfeasible, due to the high costs associated with natural gas transportation. Turkmen gas, in this regard, could increase the commercial viability of Azeri gas in the European markets due to the *economies of scale* principle in gas transportation. According to this principle, the larger the volumes, the lower is the per

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[648] Rasizade, 'The Mythology of the Munificent Caspian Bonanza and Its Concomitant Pipeline Geopolitics', pp. 144–145.

[649] Bilgin, 'New Prospects in the Political Economy of Inner-Caspian Hydrocarbons and Western Energy Corridor Through Turkey', p. 6390; Mavrakis, Thomaidis and Ntroukas, 'An Assessment of the Natural Gas Supply Potential of the South Energy Corridor from the Caspian Region to the EU', p. 1677; Lussac, 'A Deal at Last: A Bright Future for Azerbaijani Gas in Europe?'

[650] 'Shah Deniz Targets Italian and Southeastern European Gas Markets through Trans Adriatic Pipeline', *BP*, 2013 <http://www.bp.com/en/global/corporate/press/press-releases/shah-deniz-targets-italian-and-southeastern-european-gas-markets.html> [accessed 30 June 2013].

[651] 'Is Turkey Helping or Hurting the Southern Corridor?', *Natural Gas Europe*, 17 September 2012 <http://www.naturalgaseurope.com/turkey-southern-gas-corridor> [accessed 17 September 2012].

unit cost of transportation. This could, in principle, make both Azeri and Turkmen gas more competitive vis-à-vis other gas supplies in the EU markets.[652] Nonetheless, this possibility ignores two important sticking points from the regulatory point of view, which would lead to different outcomes if the EU law were to apply in Azerbaijan.

Firstly, during the negotiations on the launching of the Southern Gas Corridor Azerbaijan voiced its readiness to facilitate certain (circa 5 bcm/a) volumes of Turkmen gas via this corridor. In contrast, Turkmenistan was not interested in gas volumes less than 30 bcm/a, which is 3 times larger than Azeri Shah-Deniz II export potential to the EU. In addition to the massive investment required for the construction of the new pipelines along the SGC, such export volumes would also create additional competition for the limited market share in the EU, as well as in Turkey and Georgia, where Azerbaijan holds considerable market share. This was an especially germane problem, due to the high costs associated with gas production in Azerbaijan, as a result of which some of the Shah Deniz consortium members even divested their shares in this project.[653] In this regard, in contrast to the principles of the EU *acquis*, the ability to control the access regime to the pipelines along the Southern Gas Corridor has allowed Azerbaijani government and the upstream industry operating therein (both in the late 1990s and 2013), to tailor it to their own energy interests, as opposed to letting the market forces determine the capacity rights in the relevant transit pipelines.

This is a relevant concern for Azerbaijani government given the fact that the country's oil production is in decline.[654] Currently hydrocarbon rents account for 45% of the domestic GDP and over 70% of the country's fiscal revenues. In the future the government will have to increase its gas production from the above-mentioned green fields and export thereof to the EU and other regional markets in order to make up the reduced oil revenues. This, on the other hand, explains the government's concern about large Turkmen volumes flooding the markets that Azerbaijan itself targets for its own gas exports.

Secondly, Azerbaijani government has in past voiced its readiness to allow (*certain volumes of*) Turkmen gas to transit its territory, which is a legal obligation under the

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652 Interviews with an EC/DG Energy official, 03/05/2015, Brussels and Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

653 Guy Chazan, 'Azerbaijan to Supply Gas to Europe after BP-Led Consortium's Deal', *Financial Times*, 17 December 2013 <http://www.ft.com/intl/cms/s/0/8bd77bf8-66ff-11e3-8d3e-00144feabdc0.html#axzz2uGfw9A00> [accessed 24 February 2014].

654 Nailia Bagirova, 'Azerbaijan Expects Decline in Oil Production in 2015', *Reuters*, 28 October 2014 <http://www.reuters.com/article/2014/10/28/azerbaijan-oil-output-idUSL5N0SN4PV20141028> [accessed 18 May 2015]; Jack Farchy, 'Baku Seeks Alternatives as Azerbaijan Oil Production Declines', *Financial Times*, 12 March 2015 <http://www.ft.com/intl/cms/s/0/b86cb5b4-be99-11e4-8036-00144feab7de.html#axzz3aTZxnT5n> [accessed 18 May 2015].

Energy Charter Treaty (to which both Azerbaijan and Turkmenistan are members).[655] However, general reference to the ECT obligations conceals an important regulatory detail, which would determine the commercial viability of Turkmen gas exports via Azerbaijan.

In addition to defining pipeline *access regime*, the EU *acquis* also prescribes the principles of the "*transit"* regime, while prohibiting differential treatment of the third-party gas from domestic gas. In other words, EU *acquis* prohibits charging transit fees for the transportation of third-party gas via national transmission and/or transit lines. In this regard, if the EU *acquis* were to apply in Azerbaijan (and to the pipelines in its territory), Azeri government would not be able to demand any transit fees for the transportation of the Turkmen gas.

In this regard, although the ECT commits its members to provide transit passage to third party gas across their territories, it does not prescribe a (regulated) mandatory TPA regime under pre-published tariffs. Furthermore, unlike the EU *acquis*, the ECT does not prohibit charging transit fees to third-party gas. The latter is an important factor in gas industry, for it affects the competitiveness of gas sold in the final consumer markets. As I indicated above, excessive transit fees across Azerbaijan was one of the factors that stymied the construction of the TCP in the late 1990s. Similarly, elimination of the transit fees would diminish the transit country's incentives to invest into costly transit infrastructure in its territory, especially if the third-party transit gas will end up competing against its own gas volumes in the consumer markets.

To sum it up, the political and economic rationale behind the EU's natural gas legislation is to eliminate all non-market hurdles in energy supply and transit. Hence, if Azerbaijan were to apply the EU *acquis* domestically, it would lose its ability to tailor the *access*/*transit* regime to the above-mentioned pipelines to its own energy security interests. Regional (as well as other domestic gas producers) would be able to gain transit/transportation capacity in Azerbaijan on equal terms and compete against Azeri gas in the consumer markets. This would likely to affect the economics of Azeri gas (and government's revenues), which explains the government's vested interest in continued control over the domestic (and regional) pipelines. At the end of the day, whoever controls the gas pipelines also controls the economics of the gas sales.

Similarly, Azerbaijan aspires to become a *lynchpin energy hub* for the Caspian basin energy resources and thus, is in very much need of a *"vertical integration"* of energy assets, both

[655] This position was expressed by Azeri authorities during the sixth meeting of the Committee on Energy Security of the Euronest Parliamentary Assembly, 12 February 2013, Baku.

in the region and beyond - in Turkey and even in the EU.[656] To that end, Azeri authorities made sure that it has a controlling stake in the TANAP, which will carry Azeri gas from the Turkish-Georgia border up to the Turkey - Greece border. Depute Speaker of Milli Majlis (Azerbaijani Parliament) Valeh Alasgarov remarked that, *"the important aspect of the agreement [between Azerbaijan and Turkey on TANAP] is that SOCAR's share in the project cannot be less than 51%, [...] which is important for Azerbaijan, as a gas producing country".*[657] In this vein, in spite of Turkey's candidate status (and hence, expectation from it to apply the EU legislation domestically), TANAP is legally underpinned by a package of Intergovernmental Agreement between Turkey and Azerbaijan and the Host-Government Agreement between the Turkish government and TANAP, which regulate the construction, ownership and operatorship of the pipeline, as well as the transit of Azerbaijani gas to the EU. This enables SOCAR to exercise control over the *access regime* in TANAP and tailor it its own commercial (and political) interests.

It is also important to note that, keeping strong governmental control over the natural gas network also allows Azeri authorities to rein in the upstream industry operating its oil and gas fields. The production sharing agreements (PSAs) between the Azerbaijani government and the major international oil corporations (IOCs) on the hydrocarbon production in offshore fields were signed in the late 1990s and early 2000s. This period was characterised with the desperate need of the government for foreign direct investment, as the state energy company SOCAR could not afford extracting oil and gas by itself due to the lack of technological expertise and financial resources.[658] As a result, most of the PSAs signed with international oil majors gave SOCAR minority shares in the consortiums developing the fields. As a result, the government lost control over the investment and production rate of its own production fields. This eventually resulted in sharp criticism of IOCs by the Azerbaijani leadership *"in failing to keep promises"*.[659]

At this point of development, the political establishment in Azerbaijan cannot force the re-distribution of shareholder structure in upstream gas fields due to the fear of encroaching nationalisation in consumer countries. However, as the major export pipelines are still in the process of design, construction or expansion, SOCAR can, in principle, exert *indirect* control over the upstream by controlling the midstream. Since the domestic gas market in Azerbaijan is monopolised, international energy companies producing gas in Azerbaijan

656 'Summary of Comprehensive Strategic Development Plan of SOCAR - 2025' (SOCAR, 2013).

657 'Milli Majlis Ratifies Agreement on TANAP', *News.Az*, 20 November 2012 <http://news.az/articles/economy/72260> [accessed 23 November 2012].

658 Shaffer, 'Caspian Energy Phase II: Beyond 2005'.

659 Ilham Aliyev, Opening speech by Ilham Aliyev at the meeting of the Cabinet of Ministers, 2012 <http://en.president.az/articles/6439> [accessed 5 January 2014].

cannot sell it directly to the domestic consumers. For example, Azerbaijan International Oil Company (AIOC) produces gas in ACG fields, which is then supplied to the domestic market only by SOCAR. Any third-party access to the domestic grid (which is practically unlikely), therefore, must be negotiated with the state company.[660] Thereby, by holding firm onto its domestic transmission lines, as well as, gaining additional control over the new energy highways, Azerbaijan is trying to gain back an *indirect* control over its major production sites in the Caspian Sea.

2.3.2. Domestic veto holders

In analysing the failure of Europeanisation of Azerbaijan's natural gas sector one must look into the role domestic stakeholders and *veto holders*. This is especially important considering the *clanic* structure of business environment in the country.

In this regard, the Ministry of Energy is a state agency *formally* mandated with setting the energy policy of the state.[661] However, in reality the Ministry is at best merely informed about the energy strategy of the top leadership of the government, let alone being the key decision-maker in energy policy-making. The Ministry is rarely consulted outside the general political and economic issues concerning Azerbaijan's strategy and role vis-à-vis Southern Gas Corridor and does not wield any real weight in the domestic policy scene. In his comprehensive analysis of the political economy of Azerbaijan's energy sector, Samuel Lussac argues that, Natig Aliyev, Minister of Energy of Azerbaijan, is less informed about the strategic and commercial issues and *"[d]uring a meeting on gas transportation issues with EU officials, he was believed to only know the focal points President Aliyev presented to these very same officials four months before".*[662] Against this backdrop, it is no surprise that the four above-mentioned legislative drafts on the approximation of Azerbaijani gas legislation to the EU *acquis*, which were prepared by Ministry, were not even allowed to the agenda of the national parliament. This, consequently, speaks of the limited role that the Ministry of Energy plays in the determination of the legislative process in the country.

Against this backdrop, the State Oil Company of Azerbaijan Republic *de facto* acts as the key veto holder in the determination of the energy (natural gas) policy in the country and also aspires to become a key regional energy player.[663] Its aspirations to vertically control the entire value chain of energy production, transportation and distribution in Azerbaijan

660 'In-Depth Review of the Energy Efficiency Policy of Azerbaijan', pp. 46–47.

661 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

662 Lussac, *The State as a (Oil) Company? The Political Economy of Azerbaijan*, p. 23.

663 Abbasov, 'Azerbaijan: For SOCAR, Bigger Means Better with Azerigaz Takeover'; 'Summary of Comprehensive Strategic Development Plan of SOCAR - 2025'.

and along the entire route of the SGC do not only reflect the government's strategic energy goals. It is also conditioned by the corporate strategy to increase the visibility and commercial power of the company in the entire region. The acquisition of the entire distribution network in Georgia and a comprehensive gasification program by Azeri SOCAR is a good indication of the regional ambitions of the state company. Therefore, it comes as a little surprise that, if SOCAR is keen on acquiring new network assets in the neighbouring countries, as well as in the EU, it will be unlikely to let go of its monopoly in the domestic market in Azerbaijan.

In this regard, SOCAR has been leading the negotiations on the Southern Gas Corridor and the sales of Azeri gas to the EU and the regional markets on behalf of the government. Even during some of the key meetings of the EaP Euronest committee on energy security, it was the senior SOCAR officials (as opposed to the Ministry of Energy) that presented and defended the government's position on liberalisation process of the domestic gas market in Azerbaijan, as well as on the issues of gas transit across the country.[664] In this vein, although the state company is not formally entrusted with legislative powers in determining the energy policy in the country, it wields substantial informal powers through (also) personal networks of the company leadership.[665]

The company stands to lose commercially a great deal from the liberalisation process. The ability to control domestic natural gas networks allows SOCAR to also access markets in the neighbourhood other than the EU. For example, on March 27, 2009 SOCAR and Gazprom signed a MoU, which laid the foundation of renewed Azeri gas exports to Russia, which is carried out by Azerigaz, a subsidiary of SOCAR.[666] Obviously, it did not mark the strategic realignment in Azerbaijan's foreign policy, but was conditioned by a commercial imperative and laid the foundation of a closer relationship between SOCAR and Gazprom.[667] Azerbaijan produced twice as much gas in 2012, as it consumed domestically.[668] Market in Georgia, in this regard, is relatively small to consume the remainder of Azeri production, while Turkish gas purchases from Azerbaijan were limited to contractual volumes. Hence, in times of additional capacity Russia was able to provide an option for marketing Azeri gas. Control over the monopolised domestic and cross-border transmission pipelines, in this regard, allowed SOCAR to determine the terms and

664 This was personally observed by the author during the multilateral debates that took place during the sixth meeting of the Committee on Energy Security of the Euronest Parliamentary Assembly, 12 February 2013, Baku.

665 Lussac, *The State as a (Oil) Company? The Political Economy of Azerbaijan*.

666 'In-Depth Review of the Energy Efficiency Policy of Azerbaijan', p. 48.

667 Denison, 'The EU and Central Asia: Commercialising the Energy Relationship', pp. 7–8.

668 'BP Statistical Review of World Energy June 2013' (BP, 2013), pp. 22, 23.

conditions of Azeri gas sales to the neighbouring countries, while ensuring its consistency with the country's strategic interests.[669] On this issue, quite interestingly, the position of the Ministry of Foreign Affairs of Azerbaijan is largely in line with that of SOCAR.[670]

Furthermore, unlike in Turkey and Georgia, there is a strong link between the level of democracy and the rule of law on the one hand and the willingness to cooperate with the EU in virtually any sphere, including energy on the other. In this regard, the level of democracy has been in steady decline in Azerbaijan ever since the country gained its independence from the USSR in 1991. The Freedom House classified Azerbaijan as "not free" in its 2014 *Freedom in the World* report, with its rating in political rights and civil liberties further declining to 6 in the 1-7 scale, while 7 being worst.[671] Furthermore, following the 2013 presidential elections, OSCE/ODIHR reported *"the worst vote count ever observed by an ODIHR election observation mission anywhere [...] with 58 per cent of observed polling stations assessed as bad or very bad"*.[672] Even if European Parliament's small and questionable[673] delegation initially claimed the legitimacy of the presidential elections, the European Assembly later on rejected the conclusions of its own delegation and fully endorsed the findings of the OSCE/ODIHR mission.[674]

Such a poor state of democracy and rule of law in the country negatively affects the rule adoption process at two levels. Firstly, the entrenched *clanic* economic structures in the country have vested interests in maintaining their monopoly rights and privelegies in national economy, including and especially in energy sector. Like in many other post-Soviet countries, the political system in Azerbaijan is heavily intertwined with energy sector and energy sector has served as the backbone of the current political regime. Hence, introducing competitive market conditions in the energy sector under the EU template would not only reduce the governmental rents and thereby, undermine *national interests* of the country. Such a situation would also go against the interests of the business groups, which are intimately related with energy sector and are also intricate elements of the

669 In addition to energy supply, SOCAR also performs social duties in the country, which may help it to justify position against liberalisation.

670 Interview with Rashad Novruz, Mission of Azerbaijan to the EU, 03/05/2013, Brussels.

671 *Freedom in the World 2014* (Freedom House, 2014) <https://freedomhouse.org/sites/default/files/Freedom%20in%20the%20World%202014%20Booklet.pdf>; Increased level of political persecusion opposition and independent media was also recorded by the Human Rights Watch organisation, *World Report 2014* (Human Rights Watch, 2014).

672 *Disgraced: Azerbaijan and the End of Election Monitoring as We Know It* (Brussels: European Stability Initiative, 5 November 2013).

673 'MEPs Must Explain Trips to Azerbaijan', *European Voice*, 16 October 2013 <http://www.europeanvoice.com/article/meps-must-explain-trips-to-azerbaijan/> [accessed 22 February 2015].

674 *European Neighbourhood Policy, Working towards a Stronger Partnership: EP's Position on the 2012 Progress Reports (2013/2621(RSP))* (Strasbourg: European Parliament, 23 October 2013).

political equilibrium in Azerbaijan. Therefore, as it is the case with other EaP countries,[675] the application of the EU rules (especially those fostering competition and equality) in Azerbaijan, would seriously impinge upon the vital business interests of the powerful stakeholders, which use their monopolistic position to influence the relevant decisions of the central government. Hence, it should be expected that powerful stakeholders (whether SOCAR, or other informal power brokers) constitute a major hurdle in rule adoption in Azerbaijan.

Secondly, in view of political instrumentality of natural gas supply and transit, strong government control over the sector can also provide leverage vis-à-vis the normative pressures stemming from the EU – most importantly, the European Parliament, certain Commission services and the some member states. Since the EU regards Azerbaijan as an important player along the SGC, it is wary of aleanating the oppressive regime with reforms calls or sanctions for non-compliance.[676] The relevant high-level EU officials even made little effort to hide their different views regarding the treatment of the regime in Azerbaijan.

During their 2011 visit to Baku, the former president of the EC Jose Manuel Barroso and the former energy Commissioner Günther Oettinger concentrated their discussions on energy issues, while meeting only with the members of the government.[677] This, on the other hand, "diluted" the preceding criticism made by the former EU Commissioner for Enlargement and Neighbourhood Policy Štefan Füle, the former EU High Representative Catherine Ashton and the former president of the European Parliament President Jerzy Buzek during their earlier trips to Baku, all of whom met with the members of opposition and civil society.[678]

Furthermore, following their successive visits to Baku, Neelie Kroes - the former EU Commissioner for Digital Agenda and Günther Oettinger provided diametrically opposite views on the political situation in Azerbaijan. While the former criticised the officials in

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[675] Laure Delcour and Kataryna Wolczuk, 'Beyond the Vilnius Summit: Challenges for Deeper EU Integration with Eastern Europe' (European Policy Centre, 2013), pp. 2–3.

[676] See e.g. Jakob Hauter, 'Nothing Ventured, Nothing Gained?: The EU-Ukraine Association Agreement and the Effectiveness of the European Neighbourhood Policy', *IEP Policy Papers on Eastern Europe and Central Asia*, April 2013; Brzezinski, *The Grand Chessboard: American Primacy And Its Geostrategic Imperatives*; F. Schimmelfennig and H. Scholtz, 'EU Democracy Promotion in the European Neighbourhood: Political Conditionality, Economic Development and Transnational Exchange', *European Union Politics*, 9.2 (2008), 187–215 <http://dx.doi.org/10.1177/1465116508089085>.

[677] 2011 ECPRelease, 'Press Release: Commission President Barroso to Travel to Azerbaijan and Turkmenistan' (Delegation of the European Union to Azerbaijan, 2011) <http://eeas.europa.eu/delegations/azerbaijan/documents/press_releases/president_barroso_to_travel_to_azerbaijan_and_turkmenistan.pdf>.

[678] Jana Kobzova, Leila Alieva and European Council on Foreign Relations, *The EU and Azerbaijan: Beyond Oil* (London: European Council on Foreign Relations, 2012), p. 4.

Baku for routinely suppressing press freedom and jailing journalists, the latter spoke of a "strategic partnership" with Azerbaijan. The former energy commissioner further added that, "it is arrogant to criticise [...Azerbaijan] from a Brussels perspective, [... as Azerbaijan is] by far the most advanced on this [human rights] compared to other countries in the region - Kazakhstan, Uzbekistan and Turkmenistan."[679] The controversy took place in a context where getting the government in Baku on board with the establishment of the Southern Gas Corridor was one of the top priorities of the EC.[680] Thus, cognisant of this important role it plays in the development of the SGC, the authoritarian regime in Azerbaijan ventures to ensure its firm and full control over the energy sector by rejecting any rules-based cooperation with the EU. Azerbaijan's role as the enabler of the SGC serves as a "safety net" against international pressures on its poor governance records and provides it with an opportunity to "dictate" the terms and conditions of its cooperation with the EU. This is especially true given the fact that, unlike Georgia and Turkey, Azerbaijani government does not even aspire for membership or even association prospects with the EU.

That being said, however, this is not to suggest that democratisation of Azerbaijan would automatically lead the new government to whole-heartedly accept the EU rules without demanding certain sizeable benefits in return (e.g. membership prospects). Any decision to adopt the EU energy *acquis* would still have to be analysed in light of the relevant costs and benefits that they would usher in as I have argued above in considerable detail.

Obviously, the government is keeping the open(ended) dialogue with the EU, probably in order to keep the Russians at bay, or conceal the vested interests behind the scenes. However, it is highly improbable that this formal cooperation between the EU and Azerbaijan will lead to the genuine Europeanisation of the country.

To conclude, domestic veto holders representing the national interests, as well as the vested business interests of the *clanic* structures also inhibit the Europeanisation of Azerbaijan's natural gas sector. In overall, the government considers itself in a strong economic position and has less willingness to undertake the reforms dictated by foreign actors. It commands the necessary powers and economic resources to that end. The package-reforms exported by the EU run the risk of increasing the transparency and the rule of law in the country and present unacceptable challenge for the power base of the

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[679] Andrew Rettman, 'Azerbaijan Dangles EU Gas Bonanza', *EU Observer*, 14 November 2012 <http://euobserver.com/foreign/118199> [accessed 23 November 2012].

[680] For example, Barroso called the deal he signed with the president of Azerbaijan a major breakthrough, which "confirms Europe's direct access to gas from the Caspian basin, thus enabling the realisation of the Southern Corridor." 'Press Release: Commission and Azerbaijan Sign Strategic Gas Deal' (EC, 2011) <http://europa.eu/rapid/press-release_IP-11-30_en.htm?locale=en> [accessed 31 January 2015].

regime in Azerbaijan. Thus, it should be expected that, the dialogue on the upgrade of the PCA between Azerbaijan and the EU, whether in the form of Association Agreement or Partnership for Modernisation Agreement will be long and possibly open-ended. It will have less normative content, entailing legal commitment for rule adoption and will rather concentrate on the political/economic dialogue related to the realisation of certain projects of common interest.

3. Main findings and implications on the SGC

As I argued above, the export of the EU energy acquis to the partner countries is one of the core aims of the Eastern Partnership established in 2009, which the EU pursues in tight synergy with its Southern Gas Corridor strategy. In doing so, the bilateral track of the EaP uses a more-for-more principle as an external incentive to foster approximation of the partner counties', in our case Azerbaijan's energy legislation with the EU *acquis*. If successful, this external EU policy action has the potential to eliminate transit risks to energy supply via this country by absorbing Azerbaijan into the regulatory sphere of the EU single market. Nonetheless, as this chapter analysed in detail, Azerbaijan as a vital natural gas supply and transit country along the SGC, has not implemented the EU natural gas legislation domestically and has no incentive to do so in the foreseeable future. Rule adoption in natural gas sector has neither taken place as part of the non-binding EU programmes that Azerbaijan has been participating during the past decade. As such, this has implications on both, the EaP as a tool of external (energy) policy action of the EU, as well as the competitiveness of gas supply to the EU via this energy corridor.

3.1. EaP and Europeanisation of Azerbaijan's natural gas sector

This chapter argued that the expectations of huge domestic costs to be incurred by the adoption of the EU rules constitute the pivotal factor explaining the failure of Europeanisation of the natural gas sector in Azerbaijan. It is expected that EU *acquis* would decrease the energy revenues of Azerbaijani government by opening up the domestic gas market to competition, as well as incur opportunity costs by facilitating the freedom of access of other regional suppliers to the European markets through Azerbaijan. The latter would likely compete against Azeri gas in a way that may not be favourable to country's national interests. Energy sector has become the main powerhouse of the Azeri economy and propelled the GDP growth in the past decade. Implementation of the EU rules is, thus, seen as a risk to this progress. In addition, the Azerbaijani state energy

champion SOCAR exercises powerful (both formal and informal) veto powers against the adoption of the EU rules in the country, not least due to its corporate interests.

Under the rationalist explanatory model, these net domestic costs weigh heavier against the expected benefits, hence, rendering the rejection of the EU rules as the most optimal policy option available. Nonetheless, the context of the cost & benefit analysis process is also important for explaining the inability of the EU to foster the adoption of its rules by Azerbaijan. In this regard, the size of the reward and the credibility of the EU conditionality are important contextual factors. As such, unlike Georgia, Azerbaijan has never expressed EU membership aspirations, hence, this potential reward is not part of the latter's strategic preferences. Therefore, the prospects and the speed of its attainment does not provide critical benefits, which could incentivise the Azerbaijani government into adopting the EU rules vis-à-vis the expected net adoption costs. Furthermore, the more-for-more principle of the EaP neither offers sizeable material reward in energy sphere, either, which is of great importance for Azerbaijan. In the absence of the membership aspirations and energy specific sizeable rewards, consequently, the credibility of the conditional reward/threats becomes less relevant under the current bilateral cooperation/partnership mechanisms, including the Eastern Partnership.

In the case of Azerbaijan, the credibility of conditionality becomes even a less germane factor due to the country's practical role as the enabler of the Southern Gas Corridor, both as a supply source, as well as the major investor on the SGC pipelines. As such, even if the EU had in its disposal contractual mechanism to punish Azerbaijan for the failure of rule adoption, it is unlikely that it would be in a position to exercise it without incurring substantial costs to itself (with regard to the diversity of its energy supplies). Therefore, under current circumstances, conceptually Azerbaijan plays a role not of an *accepter*, but of a *donor*; hence, commands a better position in picking and choosing the EU rules it is interested to apply domestically and which not.

3.2. Failure of rule adoption and the competitive EU gas supply via the SGC

From the regulatory point of view, Azerbaijan presented an interesting and possibly unique case study for investigating the interplay or rather the collision between the supply and transportation/transit interests in a non-EU *supplier* country. As such, the existence of these conflicts of interests were one of the primary reasons, which gave rise to the adoption of the Third Energy Package in the EU, with a view of establishing depoliticised, liberal and integrated natural gas market in the Union. Similarly, the policies of applying the Third Energy Package along the SGC were aimed to take advantage of its problem-

solving properties by depoliticising and liberalising the supply of natural gas via this alternative gas corridor.

Since these efforts have so far failed along the non-EU segments of the SGC, as I have investigated in Chapters IV, V and VI, each non-EU segment of the SGC will now be governed by the transit and market access rules established by the relevant actors that do not necessarily share the same transit and supply interests as the EU. This is especially salient in the Azerbaijani section of the SGC. Azerbaijani SOCAR and the upstream companies operating the SCPx (first leg of the SGC) have vested strategic, but above all commercial interests in wielding producer control over the transit lines. This will allow them to tailor the access of third-party gas producers in Central Asia to the relevant transmission/transit lines to the attainment of their own strategic and commercial goals.

Against this backdrop, the Southern Gas Corridor is currently slated to bring 10 bcm/a Azeri gas to the EU starting from the year 2020, as detail in Chapter II. These volumes could prospectively be tripled or even quadrupled if other potential regional suppliers, such as Iran, Iraq and Turkmenistan could secure, at least similar to Azerbaijan, favourable transit terms to the SGC transportation capacity. Failure of Europeanisation of Azerbaijan, Georgia and Turkey, however, is likely to hamper these prospects to a certain degree and time, for neither Azerbaijan, Georgia or Turkey are interested in providing free transit without getting certain benefits in return. For this reason, the future potential of the SGC remains uncertain, as the non-market transit hurdles can (and possibly will) create capacity bottlenecks for the Central Asian and Middle Eastern gas supplies to the EU. This, consequently, will diminish the *competitive* EU gas supply via the SGC, for its functioning is also affected by the factors unrelated to the supply and demand balance in the markets.

CONCLUSIONS

With the necessary agreements in place, the physical development of the Southern Gas Corridor has entered the final home stretch with 10 bcm/a of qualitatively new gas volumes slated for the EU markets in 2020 via the combination of SCPx, TANAP, TAP and IGB pipelines. Under the current supply & demand projections, these new volumes will help to reduce the dependency of Bulgaria, Greece and Italy on Russian gas to a varying degree by diversifying the source and the transportation route of their external energy supply.

In the meantime, the gas markets in the EU have also evolved since the first inception of the idea of the SGC. Organically grown from the spillover of the intra-EU economic integration processes into the energy sector, the Union is in the process of establishing a single EU natural gas market. This is underpinned by the gradual Europeanisation of the member states' gas markets, both in *hardware* (development dense physical interconnections among the national markets) and *software* (development of EU rules governing the markets) terms. This slow but continuous progress in internal Europeanisation is, consequently, turning the EU into a single geographical market of almost continental scale.

These developments, seemingly, have also affected EU priorities with regard to the diversification of the external energy supplies and transport routes. In relation to the SGC, this is manifested in a *subtle shift* in political support to the development of the necessary infrastructure along the SGC in order to reach out to new energy sources. Previously, if the major emphasis was on the construction of the massive capacity transit pipelines *deep* into the EU markets, now it has seemingly shifted in favour of *any pipeline* that brings qualitatively new volumes to the EU *borders*. Once these new volumes reach the external borders of this continental market, internal *Europeanisation* will, in principle, ensure that gas volumes flow where they are needed most under commercial conditions.

From this viewpoint, the development of new infrastructure to deliver new gas volumes via the Southern Gas Corridor is of contribution to ensuring the EU energy security, for the diversity of energy supplies and transportation routes is a crucial element thereof. As opposed to concentrated energy provision, the diversification will allow the EU and member states to increase the resilience of their energy system by reducing dependence on the dominant supplier - the Russian Federation.

Nonetheless, the EU's external energy policy vis-à-vis the SGC has not been limited to political support to the necessary infrastructure developments. It has also involved external policy actions aimed at the *Europeanisation* of this alternative energy corridor. In this regard, by putting the latter at the heart of this PhD, the first research question of this thesis focused on the rationale behind the EU external energy governance vis-à-vis the SGC, while the second research question invited an assessment of the factors that impact upon the success of the external energy governance in question.

Having the first research question in mind, this PhD argued that, the EU's conception of energy security is *the diversity of energy supplies under competitive market conditions, which ensures its affordability and reliability.* In this regard, even though the establishment of the necessary infrastructure along the SGC is to contribute to the *diversity* of the energy supplies to the EU, further (a new dimension of) policy measures are needed to ensure the *competitiveness* of this energy corridor. Essentially, here *competitive* energy provision refers to supply and transportation of natural gas under free-market conditions, unaffected by the (geo)political bargaining power among the involved parties.

On this latter issue, this thesis refers to the emergence of transit risks along the Southern Gas Corridor, which will affect the competitiveness of the EU energy supply via this corridor. It was argued that, the main transit countries, namely, Turkey, Georgia and Azerbaijan, have the ability and interests to tailor the flow of energy resources across their *sovereign* territories to maximising national economic and/or (geo)political ends. At the practical level, this is effectuated by restricting third party access to national gas transmission and/or transit lines. Additionally, transit risks also emerge when the transit countries charge excessive and/or non-transparent charges for transiting gas.

Therefore, this thesis argued that, *Europeanisation* as an extra dimension of the EU's SGC strategy is aimed at eliminating these transit risks. By exporting its domestic rules on *unbundling, regulated third party access* and equal treatment of *transiting gas*, the EU aims to establish necessary regulatory conditions along the SGC within which the flow/trade of energy can be ensured by the free-market principles (based on supply and demand signals), without non-market interference of the state and non-state actors concerned. In addition to economic rationale, this would also help the EU to *depoliticise* external energy supply; in other words, ensure that external supply of natural gas is not used as a political tool in international political interaction.

In investigating the potential practical role of the EU-sourced *formal institutions* in the functioning the SGC, I analysed EU enlargement process vis-à-vis Turkey and the EaP instrument vis-à-vis Georgia and Azerbaijan. By taking advantage of the *logic of calculus* of

Rational-Choice Institutionalism, this PhD argued that, at the broader conceptual level the regulatory dimension of the SGC is geared towards addressing the external energy supply risks by expanding the boundary of the EU institutions (relevant energy *acquis*) to absorb the SGC countries and hence, take advantage of their problem-solving properties.[681] The deployment of the EU institutions externally (*Europeanisation*) would allow the Union to determine the parameters (rules) that condition the capacity of third (Turkey, Georgia and Azerbaijan) countries to make energy related strategic decisions (the conditions of right of supply and transit) along the SGC and tailor them to the EU preferences. Ultimately, by Europeanising the SGC countries, the EU would gain *institutionalised soft power* over them by constraining their strategic policy actions within the institutional framework of its own making.

In this regard, I argued that RCI presents a flexible theoretical tool, as it does not directly favour *free-market* or *geopolitics* approach in its conception of what constitutes a rational action in relation to diverse and competitive gas supply via the SGC. Rational action is considered as the deployment of institutions in order to reduce the risks stemming from the behaviour of *others* by narrowing down the strategic policy options available for them. In the SGC context, this logic entails strategic implications, for it is set to bind the strategic capacity of one group of actors with the preferences of another. However, in doing so it does not contradict liberal precepts, for the institutionalisation of external energy relations based on domestic norms also envisages the export of the EU's *free-markets* model to third countries. Hence, by accounting for the role of the formal institutions (EU *acquis*) in a strategic context (elimination of external transit risks), RCI better engages with the first research question of this thesis on the politico-economic rationale behind the EU policy of *Europeanisation* towards the regulatory governance of the SGC.

In order to engage with the second research question, the External Incentive Model as the first order adaption of the RCI, provided a tailor-made analytical tool to analyse the role of *domestic costs* in Turkey, Georgia and Azerbaijan in conditioning their willingness to adopt the EU rules in natural gas sector in a *cause and effect* manner. In doing so, I argued that, *in the absence of the EU membership prospects or the lack of membership aspirations, the net domestic adoption costs in the target SGC countries serve as the inhibiting factors of energy Europeanisation of the SGC countries. Since these domestic costs stem from the SGC countries' rational national interests to control the supply and transit of natural gas to and across their sovereign territories in order to further national strategic and economic ends, they are intrinsically incompatible with the EU's conception of competitive, hence,*

[681] For a general theoretical and conceptual discussions, see Lavenex, 'EU External Governance in "Wider Europe"', p. 694.

depoliticised energy supply and transit. Consequently, the SGC will continue to be influenced by the (geo)political and economic motivations/interests of the transit states concerned, which will render the EU supply of natural gas via this corridor *uncompetitive* and *politicised* – i.e. not subject to the free-market dynamics as envisaged by the EU's notion of energy security.

Research findings in Turkish, Georgian and Azerbaijani segments of the SGC

The empirical analysis of the regulatory regime in the Turkish natural gas sector revealed that, although Turkey is an EU candidate, transposition and application of the EU's energy *acquis* in the country has not been easy and successful ever since the start of the accession negotiations. As was investigated in Chapter IV, several factors have played inhibitive role in the way of Europeanisation of Turkey's energy sector. Despite Turkey's a quarter of a century old membership application, the achievement of the final reward is still uncertain if not impossible. Nevertheless, this uncertainty in eventual membership can only partially explain the overall compliance with the EU *acquis*, as the application of the EU energy *acquis* to Turkey is not non-existent, but is rather selective.

That is to say, the Turkish government is keen on capitalising on the EU experience in certain sectors of energy system (renewables, electricity sector and in relation to energy efficiency), but reluctant in others (natural gas). To this end, I have argued that, such a selective implementation of the EU *acquis* can be explained by the net domestic costs that Turkey would incur in adopting the EU natural gas legislation without ensuring credible and foreseeable membership prospects.

In this regard, we can observe that there are two opposite trends taking place in Turkey's energy policy in relation to renewables and electricity sector on the one hand and natural gas sector on the other. With regard to the former, the Turkish government seems to be keen on tapping into the domestic renewable energy sources and liberalising domestic electricity market. In doing so, it is willing to capitalise on the EU practice and ensuring market convergence and integration with the neighbouring countries, including the EU.

On the other hand, when it comes to the national gas market, the Turkish government seems to be paying only lip service to harmonising its domestic policies with that of the EU and ensuring freedom of gas transit across its territory. In reality the government is keen on holding onto its formal capacity to exert control over the transit of gas across its sovereign territory and hereby, influencing regional (and continental) energy trade and (geo) politics.

In this vein, the preferences of the Turkish government is exogenous to the process of institutional reforms that it has enacted or refrained from enacting, in other words, to institutional outcome. The institutions that it is confronted with (EU energy *acquis*) do not serve as a basis/template of good or bad behaviour. They rather present options for policy choice, the selection or non-selection of which is determined by the costs incurred or benefits accrued. What constitutes a cost or benefit is determined by the preferences of the (Turkish) government, which are or can be affected by the acceptance or non-acceptance of the EU *acquis* (formal institutions); however, are not conditioned (affected) by them as the scripts of appropriate behaviour. In other words, *preferences* are determined outside the process of decision-making on whether to adopt or reject the EU rules.

In practice, these *preferences* are related to Turkey's desired role in energy relations. Turkey is a growing consumer, as well as a key transit country on the way towards the EU markets. Therefore, the power to affect energy transit/trade across its territory feeds into the political and economic muscles of the Turkish government and plays a central role in Turkey's economic and (geo)political strategy. Thus, as explained by the RCI, the interaction of Turkey with the EU-sourced *formal institutions* (in our case, their adoption or rejection) is juxtaposed against its above-mentioned preferences in a strategic setting, the outcome of which is determined by a rational action - measuring expected costs against benefits.

As the empirical Chapter IV argued, structurally, it appears that institutionalisation of Turkish natural gas sector under the EU template, without tangible progress in EU accession negotiations, would confer upon Turkey considerable net *domestic costs*. Therefore, in line with the predictions of the EIM, the Turkish government's choice to not to apply EU legislation domestically is only rational, for it will allow Turkey to hold on to its national control of energy transit across its territory and keep on taking advantage of its material benefits.

From the viewpoint of the central thesis of this PhD, this outcome will likely to carry transit implication on the EU supply of natural gas via the SGC across Turkey. This is rather because, market based energy supply via the SGC could only be achieved if the regulatory regime along the corridor were ensured in such a way that the ownership of gas volumes transported via the major infrastructure(s) were irrelevant for the owners and the operators of this very infrastructure(s). In the case of Turkey, the separation of the gas supply and transportation activities of BOTAS and the implementation of regulated TPA regime within Turkey, would have allowed third countries to engage in direct energy

relations with the EU without being hindered by the Turkish government's or BOTAS's commercial and political interests. Hence, as BOTAS (or any other company owning the transmission lines) would not be able to discriminate among domestically destined or transiting gas in terms accessing Turkish transmission (or transit) lines, energy export to the EU or any other consumer markets via Turkey would then be determined solely based on market fundamentals. As I have investigated in Chapter IV, this has not been the case in the Turkish section of the SGC.

Despite the progress achieved with regards to TANAP, the necessity of establishing EU-sourced regulatory regime in Turkey remains all the more relevant. The maximum transportation capacity of TANAP is only 31 bcm/a, 16 bcm/a of which has already been contracted for 25 years for the transportation of SH II volumes to the EU and Turkish markets. The remaining available capacity of TANAP can easily be filled with volumes to be produced from other fields in Azerbaijan, such as Umid, Absheron, Babek, etc. As TANAP does not envision regulated (mandatory) TPA regime, it will not guarantee transportation capacity for, for example, Iranian, Iraqi or Turkmen gas when/if they become available. This will likely require the usage of the Turkish national transmission system for the transportation of these Middle East and Central Asian gas volumes to the EU. This, consequenly, will still necessitate the establishment of a favourable to transit regulatory regime in Turkey, whether through Europeanisation of the Turkish domestic legislation or based on intergovernmental agreement that provides equal pipeline access opportunities for all the relevant third-party gas. Therefore, without the establishment of the market-based transit regime in Turkey, the Southern Gas Corridor risks being limited to current export capacity (10 i.e. bcm/a), which will provide only limited contribution to the improving the resilience of the EU energy security.

Consequently, this means that under current circumstances, supply of natural gas to the EU via the Turkish segment of the SGC will not conform to the former's conception of energy security, which includes both the diversity, as well as the competitiveness of the supplied energy. Since *competitiveness* criterion requires the elimination of non-market interference to energy supply/transit, in the case of Turkey, it can be concluded to be a failed effort.

Chapters V and VI analysed the Europeanisation of the natural gas markets of Georgia and Azerbaijan within the framework of the Eastern Partnership. The latter has declared the export of the EU energy *acquis* to the partner countries as one of the core aims and therefore, is pursued in tight synergy with its Southern Gas Corridor strategy. In doing so, the bilateral track of the EaP uses a more-for-more principle as an external incentive to

foster approximation of the partner counties', in our case Georgia and Azerbaijan's energy legislation with the EU *acquis*. If successful, this would have the potential to eliminate transit risks to energy supply via this energy by absorbing Georgia and Azerbaijan into the regulatory sphere of the EU single market.

Nonetheless, the empirical Chapter V revealed that, despite Georgia's EU membership aspirations and its contractual (legal) commitment to approximate domestic energy legislation with the EU *acquis* as part of the EU-Georgia Association Agreement, rule adoption in the country is currently hindered by the expectations of certain *net domestic costs*. Georgian government is concerned about the impact of the EU *acquis* on the transit benefits and cheap domestic gas that the government currently enjoys without bringing about comparable benefits in natural gas sector in specific or in the attainment of the EU candidate status in general. Therefore, in order to minimise the economic and energy security costs of rule adoption, the government intends to tailor the depth and timeline of the implementation process to the necessity of receiving these benefits for a considerable period of time.

Nonetheless, as the explanatory argument of this thesis goes, the impact of the net adoption costs in rule adoption must be viewed in the context of the promised reward, since the role of the reward is not symbolic but material. The promised reward in return for rule adoption carries out the function of augmenting the benefits against the costs. That is to say, although the costs are assumed to be pre-given, as they are underpinned by the exogenous preference formation of Georgia (to be able to benefit from energy transit and purchase benefits), their weight could be rendered smaller vis-à-vis the prospective benefits. In practical terms, this would require the EU to offer Georgia a bigger reward in order to tip the scale of the cost-and-benefit nexus in favour of the latter. Hence, in support of the explanatory argument of this thesis, *net adoption costs* play a decisive role in rule adoption in the context of lack of *membership prospects.* Since the EaP does not envisage membership prospects or any comparable energy-specific benefits for Georgia, its contractual outcome - AAs, have few chances to succeed in fostering the adoption of the EU energy market rules along the Georgian segment of the SGC.

Against the backdrop of the failure of Europeanisation of Georgia's natural gas sector, the transportation/transit of Caspian Basin natural gas through this country will continue to be subject to political and economic bargaining between the Georgian government and the relevant public and private actors involved in the SGC. This, in turn, renders the supply of energy across Georgia *uncompetitive.* Under *competitive* market conditions the transit of Caspian energy to the EU market must not be affected by the non-market interventions by

the Georgian government aimed at securing cheap prices for the domestic consumers. Nor it must be linked to the attainment of additional fees in return for providing the freedom of transit across its territory, as envisaged by the EU natural gas market rules. Nonetheless, the detrimental impact of the failure of Europeanisation of Georgia on the *competitiveness* of gas supply via the SGC can be expected to be less stark than in Turkey. This is supported by two factors.

Firstly, unlike Turkey, successive Georgian governments have been pursuing less aggressive energy diplomacy vis-à-vis its neighbours. In this context, Georgia has never aspired to play the role of a middleman in the transportation of Caspian hydrocarbon resources to the Western/world markets - buying Caspian gas in cheap and re-selling it to the Western consumers more expensively. They have only satisfied with transit benefits and cheap gas volumes that they have been receiving from the neighbouring producers. Furthermore, Georgia does not control the transit pipelines traversing its territory. Hence, its *day-to-day* political and economic interference to the gas transit across its territory is minimal.

Secondly, even though Georgia is still an important component of the SGC, from the EU perspective, the application of the EU energy acquis in Georgia would only make considerable difference if Turkey were also to apply the energy *acquis*. Otherwise, the Europeanisation of Georgia alone would make the country an island surrounded by non-EU regulatory regimes, as there are no direct linkages between the Georgian and the EU market(s).[682] Thus, energy Europeanisation of Georgia is less relevant if Turkey (and Azerbaijan) is not Europeanised at the same time.

This is true not only from the *competitiveness* point of view, but also from the perspective of *diversity* of supply via the Georgian section of the Southern Gas Corridor. The country plays a transit role for gas supplies originating only from Azerbaijan or through it. In this regard, if non-Azeri gas volumes (e.g. from Central Asian countries such as Turkmenistan or Uzbekistan) were to be shipped to the European markets via the SGC using a trans-Caspian link, then they would have to negotiate their pipeline access rights in Azerbaijan first. Therefore, the success of Europeanisation of Georgia would make sizeable difference for the *competitive* and *diverse* supply of energy via the SGC only if similar rule adoption processes also take place in Azerbaijan, too.

[682] This point was highlighted during one of my elite interviews with a key DG Energy/EC official, 03/05/2013, Brussels. Furthermore, in his speech during a High Level Reflection Group conference at the European Parliament on 20/03/2014, the former EU Energy Commissioner, Günther Oettinger also underlined this curious fact that "Georgia will become the first Contracting Party without being physically interconnected - neither for electricity, nor for gas - with any of Energy Community Parties." - Oettinger, 'Speech: An Energy Community for the Future'.

Similarly, as the empirical Chapter VI argued, Europeanisation of the natural gas sector of Azerbaijan has failed, both within the framework of the EaP and many other preceding EU external governance instruments. The chapter argued that the expectations of huge net domestic costs to be incurred by the adoption of the EU rules constitute the pivotal factor explaining the failure of this attempted Europeanisation. EU gas market rules is expected to decrease the energy revenues of Azerbaijani government by opening up the domestic gas market to competition. Secondly, it would also incur opportunity costs by facilitating the freedom of access of other regional suppliers to the European markets through Azerbaijan. The latter would likely compete against Azeri gas in the consumer markets (including the EU market) in a way that might not be favourable to country's national interests. Energy sector has become the main powerhouse of the Azeri economy and propelled the GDP growth in the past decade. Implementation of the EU rules is, thus, seen as a risk to this progress. In addition, Azerbaijani state energy champion SOCAR exercises powerful (both formal and informal) veto powers against the adoption of the EU rules in the country, not least due to its corporate interests.

Under the rationalist explanatory model, these net domestic costs weigh heavier against the expected benefits, hence, rendering the rejection of the EU rules as the most optimal policy option available for Azerbaijani government. Nonetheless, as was the case with Turkey and Georgia, the context of the cost & benefit analysis process is also important for explaining the inability of the EU to foster the adoption of its rules by Azerbaijan. In this regard, the size of the reward and the credibility of the EU conditionality are important contextual factors. As such, unlike Georgia Azerbaijan has never expressed EU membership aspirations, hence, this potential reward is not part of the latter's strategic preferences. Therefore, the prospects and the speed of its attainment does not provide critical benefits, which could incentivise the Azerbaijani government into adopting the EU rules vis-à-vis the expected net adoption costs. Furthermore, the more-for-more principle of the EaP neither offers sizeable material reward in energy sphere, either, which is of great importance for Azerbaijan. In the absence of the membership aspirations and energy specific sizeable rewards, consequently, the credibility of the conditional reward/threats become irrelevant under the current bilateral cooperation/partnership mechanisms, including the Eastern Partnership.

In the case of Azerbaijan, the credibility of conditionality even becomes a counterproductive factor due to the country's role as the enabler of the Southern Gas Corridor, both as a supply source, as well as the major investor on the SGC pipelines. As such, even if the EU had in its disposal contractual mechanism to punish Azerbaijan for the

failure of rule adoption, it is unlikely that it would be in a position to exercise it without incurring substantial costs to itself (with regard to the diversity of its energy supplies). Therefore, under current circumstances, conceptually Azerbaijan plays a role not of an *accepter*, but of a *donor*, hence, commands a better position in picking and choosing the EU rules it is interested to apply domestically and which not.

Consequently, the Azerbaijani section of the SGC will be governed by the regulatory regime that will not be in line the EU interests. Azerbaijani SOCAR and the upstream companies operating the SCPx (first leg of the SGC) have vested interests in wielding producer control over the transit lines. This will allow them to tailor the access of third-party gas producers in Central Asia to the relevant transmission/transit lines to their own commercial and political preferences.

Policy implications

The Southern Gas Corridor will initially supply 10 bcm/a of Azeri gas to the EU starting from 2020. These volumes will help relevant EU member states to reduce their pre-existing energy vulnerability stemming from over-dependence on a concentrated external supply source. Prospectively, these alternative natural gas volumes could be tripled or even quadrupled by extending the corridor to include Iran, Iraq and Turkmenistan. These countries have vast reserve potential and linking them up with the SGC would be of huge contribution to the diversity of the EU energy supplies.

Nonetheless, this PhD argued that, although the necessary agreements for developing the SGC are in place, the EU has been unsuccessful in resolving natural-gas-specific transit risks across Turkey, Georgia and Azerbaijan. Due to the failure of Europeanisation of these main transit countries, the transit risks (will) affect not only the delivery of Azeri gas on a free-market basis, but also those from Iraq, Iran and Turkmenistan. One possible policy implication of this development is that, the SGC as an alternative energy corridor risks being limited to its current supply capacity or at least to supply volumes only from Azerbaijan. This is rather because none of the SGC countries are interested in providing freedom of transit across their respective territories without getting certain economic (and geopolitical) benefits in return. This, accordingly, runs the risk of making Iraqi, Iranian and Turkmen gas deliveries to the EU economically unfeasible; any non-market costs of energy supply and transportation will have to be covered at the expense of supplier profits, or passed on to the final consumers, while making it commercially uncompetitive.

Additionally, due to the failure of Europeanisation and hence, depoliticisation of the transit and supply regime along the SGC, the corridor could also bring about certain (geo)political risks to the EU energy security. As I argued in the empirical chapters above, the political establishments of the relevant SGC transit countries have vested interests in linking the freedom of transit and supply across/from their territories to the attainment of certain political dividends. Thus, the negative implications of the failed Europeanisation transcend the immediate boundaries of commercial energy supply and run the risk of ushering in geopolitical problems; ironically, similar to those problems that the SGC was originally conceived to resolve.

Further academic research

It is also worth noting that this PhD concentrated only on the energy specific aspects of the EU external governance vis-à-vis the SGC countries. Hence, other aspects of the external Europeanisation efforts - those targeting the general governance reforms in certain SGC countries have remained outside the scope of this research. These reforms, especially those aimed at the establishment/improvement of rule of law, democratic governance and protection of human rights have also consequences on the EU energy supply through and from the SGC countries. The latter do not have the best track records in this area.

On the one hand, this raises a number of questions as regards the prospects of practical implementation of the EU energy legislation in the SGC countries (if they were to be adopted) without reforming and strengthening of their governance institutions, both legislative and executive, as well as the judicial. On the other hand, this also raises concerns with regard to the compatibility of partnership and cooperation with autocratic energy supply/transit countries along the SGC with the EU's broader *normative* agenda; indeed, the relationship between the rational energy interests and normative governance values. In this regard, although this PhD did not engage these important questions due to the specific focus of research, as well as the time and space constraints, the investigations of these aspects of the EU external governance vis-à-vis the SGC countries merits further academic attention.

Last but not least, this thesis concentrated only on the transit risks specific to natural gas transportation via the long-haul pipelines. Other risks, such as (military) security, technical or even market risks stemming from the supply and demand misbalance in the consumer markets remained outside the scope of this research. It is also important to note that, the investigations of these aspects of the EU energy supply via the SGC also merits new academic research, especially in light of the geopolitical cataclysms taking place in the

Middle East and the Caspian Basin in the wake of civil wars and intensified aggressive geopolitical plays by the regional states.

APPENDIX I: RESEARCH METHODS

As noted in Chapter I, I relied on the *"three fundamental actions underlying the techniques of qualitative research",* namely, *"observing, asking and reading"*[683] for investigating the subject matter of this thesis, which I will explain in further detail below. In using any of the following research techniques, my main motivation was always to *infer,*[684] guided by the theory, beyond the immediate empirical data and try to relate the thick description about the problem to the broader theoretical and policy issues.

Document analysis

The analysis of the *institutional* documents, which were produced by the legislative and executive bodies, non-governmental organisations, international agencies and companies and other institutions, was at the heart of this research endeavour. In general, among the primary sources, I used the following, non-exhaustive list of publicly available documents[685]:

- European Commission communications and reports,
- European Council and the Council conclusions,
- Primary and secondary EU legislation,
- European Parliament resolutions and reports,
- Documents produced by the Eastern Partnership institutions,
- International agreements,
- Statistical material produced by the relevant energy companies and international institutions, such as BP Statistical Review, World Energy Review and Natural Gas Statistic by the International Energy Agency (IEA), etc.,
- Online newspaper articles,
- Domestic legislation of the non-EU SGC countries,
- Energy policy reports and strategy documents produced by the governments of the SGC countries,
- Official speeches, Etc.

683 Corbetta, 'The Use of Documents', p. 307.

684 On the role of "inference" in social research, see e.g. Gary King, Robert O Keohane and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton, NJ: Princeton Univ. Press, 1994).

685 In addition, secondary sources, such as journal articles and books were also utilised, both for the purpose of acquiring data, as well as referring to pre-existing analytical positions on the subject matter investigated.

In general, these primary sources provided me with open access to huge amount of information, which has not yet been utilised in order to investigate the subject matter of the current research. As such, the *institutional documents,* as the primary research *data*, allowed me to construct the thick description and analysis of the institutional reality I aim to analyse guided by the theoretical framework of this thesis. In doing so, in line with *qualitative research* in general, may aim was to explain why and how the known causes (domestic costs) have led to known effects[686] (failure of rule adoption), although both of which I had to describe first, as the empirical terrain was very new to academic research.

In general, the use of *institutional documents* had its own benefits, as well as drawbacks. In terms of benefits, since these documents have been produced independently of the actions/involvement of the researcher, they are both, 'non-reactive' - *"not subject to possible distortion due to the interaction between the researcher and the subject studied"*[687] and relatively sincere in providing information compared to, e.g. *elite interviews*. With regard to first, as a researcher I was not involved in the production of data, i.e. preparation of the *institutional documents* in question. Hence, they are not distorted by the act of recording by the researcher. With regard to the latter, additionally, the authors of these documents had created them with their general interests (in our case, energy and political interests) in mind and were not solely targeting the aspects of the subject matter I am investigating in this thesis. Hence, they had little or no reason to "make a good impression" or follow the socially acceptable behaviour/politeness in positioning their viewpoints.[688] For example, since this PhD is investigating the non-/compliance of the SGC countries with the EU energy *acquis*, the *institutional documents* provide a more sincere and objective source of data for that purpose. As such, e.g. an elite interviewee from Turkey can claim that the country has harmonised its domestic legislation with that of the EU Third Energy Package, or an interviewee from the EU institutions may claim the opposite. In doing so, they express their personal take and propagate their agenda on the subject, which might be (and was validated during my investigations) affected by the political bias or official policy line. On this issue, especially, the Turkish officials were not necessarily honest or objective.

On the contrary, the *institutional documents* produced by the Turkish legislative body and the government, for example, Turkish Natural Gas Market Law, provides objective and "honest" data and cannot lie about the compliance or non-compliance with the EU *acquis*.

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[686] See e.g. Ariadne Vromen, 'Debating Methods: Rediscovering Qualitative Approaches', in *Theory and Methods in Political Science*, ed. by David Marsh and Gerry Stoker, 3rd edition (Basingstoke: Palgrave Macmillan, 2010), pp. 249–66 (p. 255).

[687] Corbetta, 'The Use of Documents', pp. 287–288.

[688] Corbetta, 'The Use of Documents', pp. 287–88.

Additionally, since those documents and data contain therein were produced outside the scope of this research and by the actors other than the researcher (i.e. me), they are not *distorted* by the latter's personal input into the production process. In other words, the use of *institutional documents* brings authenticity and credibility to the data they provide.[689] Hence, the use of *institutional documents* are more in line with the positivist epistemology and ontology of this PhD, than some other qualitative research techniques.

Nonetheless, the use of *institutional documents* had also a number of drawbacks. Firstly, as I indicated above, these documents were not particularly produced with the subject matter of this PhD in mind. Hence, they lacked some important information - they were *incomplete*. As such, being an already existing source of information, I had no possibility to "ask further questions" to fill in the gaps in data collection.[690]

Secondly, *institutional documents* would not always provide the *"objective representation of the institutional reality to which they refer, but instead provide an 'official' representation of it".*[691] For example, an SGC country's compliance with the EU *acquis* can be investigated at two levels: firstly, by the availability of legislative framework in the country, which is ensured by the adoption of the necessary legislative documents. As such, the existence of certain legal prescriptions should not be automatically equated to their implementation in practice. For example, this research revealed that although Turkey has adopted some of the legal provisions in line with the EU *acquis* (e.g. unbundling of natural gas supply from transmission), it does not necessarily implement them in practice. This gives rise to a practice known in Europeanisation literature as "*Potemkin harmonisation*", referring to the difference between *official/formal* compliance and *practical* compliance. Hence, in order to avoid this *official bias* given rise by the use of *institutional documents*, it is important to triangulate the official data with other sources of information depicting practical institutional reality.

In another example, the role and the real power of the domestic veto players in rule adoption cannot necessarily be realistically expressed by the *institutional documents*. For example, in Azerbaijan the Ministry of Energy is officially/formally responsible for the determination of state policy on energy, both in relation to domestic supply and foreign energy policy. Nonetheless, the real - practical distribution of powers is fairly different; State Oil Company of Azerbaijan (SOCAR) holds the "real" powers in the development of the SGC than the Ministry in question.

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689 See e.g. Tim May, *Social Research: Issues, Methods and Process*, 4. ed (Maidenhead: McGraw Hill, Open Univ. Press, 2011), pp. 175–200; Vromen, 'Debating Methods: Rediscovering Qualitative Approaches', pp. 262–63.
690 Corbetta, 'The Use of Documents', pp. 287–88.
691 Corbetta, 'The Use of Documents', p. 306.

Hence, as such although the use of *institutional documents* provide absolutely crucial source of data for analysis, it is by no means sufficient and need to be complemented by other research techniques, that can capture both "official" and "practical" reality.

Observation

In this context, the passive participant *observation* provided an important method for me to enrich my personal knowledge and sharpen my sense of the subject matter, but not for the purpose of *interpretation*[692] of the social behaviour of a particular group, as this method is usually associated with. Passive personal *observation* of the main policy developments was key for practically understanding the formalised avenues of rule transfer from the EU to the SGC countries and their general effectiveness, which cannot necessarily be captured in the institutional documents (such as meeting minutes, reports, etc.). In specific terms, these formalised avenues of rule transfer were divided into bilateral and multilateral fora. While the later were publicly accessible, the former largely remained outside the public domain. Each of these formalised avenues had their benefits and drawbacks.

To start with, at the multilateral level the energy committee of the Euronest parliamentary assembly of the Eastern Partnership provided an accessible avenue for the observation of the discussions by the members of the European Parliament and the EaP countries. As such, the Euronest PA was conceived to provide parliamentary (legislative) oversight over the political and economic integration of the EaP countries to the EU; hence, serve as a complementary (to executive branch) channel for the promulgation of national interests. From the perspective of this research, this allowed me to have a comprehensive understanding of the national energy interests of the SGC countries concerned (namely Georgia and Azerbaijan) without being constrained to the viewpoint of the executive branch alone.

Secondly, by observing the discussions/negotiations in real time, I was able to sense the difference between the "formal" and "practical" reality in relation to the propagation of national interests, as well as in relation to the distribution of real powers affecting the policy outcomes. For example, the investigations revealed that the EU-Azerbaijan memorandum of understanding on energy (2006) include the non-binding commitments by the Azeri authorities to harmonise domestic legislation with the EU *acquis*. As such, since the memorandum of understanding is a voluntary document expressing one's

[692] See e.g. Russell A. Jones, *Research Methods in the Social and Behavioral Sciences*, 2 Sub edition (Sunderland, Mass: Sinauer Associates Inc, 1996); Piergiorgio Corbetta, 'Participant Observation', in *Social Research: Theory, Methods and Techniques* (London ; Thousand Oaks, Calif: SAGE Publications, 2003), pp. 235–64.

intents, it could be assumed that Azerbaijan has interests in this legislative harmonisation with the EU *acquis*. However, during the bilateral and multilateral meetings that I had attended, which included the discussions of the policy actions stemming from the mentioned memorandum (and other similar institutional documents) in their formal agenda, the Azerbaijani authorities did even talk about legislative harmonisation as their policy priority. Compared to the EU officials, who made systematic references to the benefits of legislative harmonisation in the development of the SGC and regional energy cooperation, Azerbaijani officials put the emphasis on the necessity of the EU political and financial support to the development of the SGC, thereby, their "real" interests, as opposed to "formally-declared" ones, which I cross-referenced with the data acquired through the *elite interviews* (discussed below).

Additionally, as I mentioned above, the practical distribution of power in policy choices cannot be entirely captured through the *institutional documents*. In this vein, passive participant observations came very handy in my research endeavours. By attending the relevant multilateral and bilateral meetings and listening to speeches and discussions, I developed a sharp sense of reality as to who are the real actors behind the policy choices made by the countries in question. This was especially relevant during the questions and answers sessions. For example, when the Azerbaijani authorities were confronted by the questions on the subject of the potential contribution of the EU *acquis* to the future functioning of the SGC, it would always be the officials from SOCAR would take up the floor to answer them during the Euronest PA meetings, as opposed to the MPs or the officials from the Ministry of Energy.

With these in mind, I have attended the *sixth* and *seventh* meetings of the Energy Committee of the Euronest Parliamentary Assembly on 12/02/2014 and 04/11/2014 respectively, which took place at the European Parliament in Brussels/Belgium. In addition, I observed the fourth meeting of the same committee, which took place in Baku/Azerbaijan on 12/02/2013 via live public broadcasting. Since the agendas of these mentioned meetings were long and comprehensive and included all the elements of energy partnership with the EU, I took specific notes only in relation to the rule adoption in natural gas sector by the EaP countries. I used these notes as a primary, but complementary source of information for the purpose of this research. Although the meeting minutes were later made public, their quality were not up to the standard and hence my personal notes came very handy.

However, the Euronest meetings alone did not provide comprehensive, detailed understanding of national interests of all the EaP countries, which are under the focus of

this thesis, namely, Azerbaijan and Georgia. Although the MPs from the former were straightforward and consistent with the executive in the views of the impact of the EU energy legislation on the national interests of Azerbaijan, representatives from Georgia were less so open in their support or rejection of the EU natural gas legislation. Furthermore, Turkey – important segment of the SGC, is not a member the EaP, hence Turkish MPs do not participate in the Euronest committees. Hence, although this forum provided me with detailed information in relation to the national particular group of actors (mostly Azerbaijan), its findings cannot be generalised vis-à-vis the rest of the SGC countries. Therefore, observing the Euronest meetings alone cannot be used as a single comprehensive method of research for this thesis.

Additionally, I was only a *passive observant*, I did not have a chance to ask questions and specify the issues, which are important for this PhD. On the positive note, this allowed me not to distort the data I was collecting. However, it also meant that I had no chance to ask further questions and fill in the gaps in data that I required.

Secondly, the bilateral track of the EaP, which is carried out in the Partnership and Cooperation Agreement (PCA) committees between the EU and the EaP countries, provided me with a more intimate avenue for observation and collecting data on the discussions related to rule transfer to the EaP countries and the individual positions of the receiving countries. I attended the EU-Azerbaijan PCA sub-committee on energy, transportation and environment on 11/02/2014 in Brussels/Belgium. The Mission of Azerbaijan at the EU facilitated my attendance at the meeting and my research credentials were verbally presented to the participants during the meeting. I personally requested the Mission to present my researcher status due to the ethical considerations. In general, this meeting provided me with a unique opportunity to glean the views of the sides on the matters of bilateral energy cooperation, most of all in relation to prioritised interests of the parties. However, as it was the case with Euronest meetings, the information acquires is only pertinent to small groups and as is usually the case in participant observation, the results cannot be generalised over other groups.[693]

Last but not least, since a great deal of policy debates take place in the public domain in Brussels/Belgium, I spent several months in Brussels in order to interact with the relevant public officials and the policy discourse they carry out. I attended meetings organised both by the public and private actors, as well as research organisations in order to improve my understanding of the EU energy policy in general.

[693] Corbetta, 'Participant Observation'.

To sum up, I used the participant observation as a research method only in order to complement, fill in the blind spots of the data provided by the *institutional documents*.

Elite interviews

Although passive personal observations were very helpful for furthering my grasp of the energy affairs, they were not always useful for getting necessary data. Especially, considering that energy issues are very sensitive, not all information is publicly disclosed. Hence, in order to collect further qualitative data and glean the official but not-publicly declared views of the relevant policy actors, I conducted semi-structured *elite interviews* with relevant official figures involved in the negotiations of different aspects of the SGC. Elite interviews also came handy in collecting first-hand information on the issues, which were not necessarily sensitive, but still lacked public documentation for variety of reasons.

In order to carry out these elite interviews and be compliant with research ethics[694], I initially searched the potential interviewees online and approached them via email, explaining my research and the contribution that I seek from them. The officials were chosen taken account of their involvement in the development and negotiations around the SGC. At the same time, in order to reach out to other potential interviewees, whose details could not be found online, I also used the snowballing process.

Upon agreement to give an interview, we arranged the date and place. During the interviews, I presented each and every interviewee with an *interview consent form* of the University of Sheffield, which they read and signed. Not all interviewees allowed me to audio-record the interview. In those cases I only took handwritten notes. At the same time, very few interviewees allowed me to use attributable quotes in my thesis. In those cases, in order comply with the research ethics I used anonymous quotes and/or information in my thesis, by referring to the relevant officials by only citing the institution they represented, place and date of the interview. In general, elite interviews served both as a tool of data collection, as well as analysis.

During the interviews, not all the interviewees were willing to be open and frank in expressing their views mostly due to the sensitivity of the subject matter discussed. In order to overcome this problem, I tried to not to reveal my normative position in advance and be open to any viewpoint. At the same time, I made every effort to be prepared to the discussions by carrying out background research on the interviewees (whenever relevant) and have their past public declarations (if available) with me in case if they would provide opposite view during the interview.

694 William S. Harvey, 'Strategies for Conducting Elite Interviews', *Qualitative Research*, 11.4 (2011), 431–41.

In total, I carried out 16 *semi-structured* interviews.[695] The questions of the interviews were designed to be open-ended and organised around the *factors* that this thesis seeks to attribute the institutional outcome, although the order of questions and precise formulation varied from interview to interview. This was conditioned by the different context in each empirical study and the specialised focus of each interviewee. In general, the contribution of elite interviews to my research was targeted and qualitatively important. They allowed me to unearth some of the empirical facts that were crucial to my thesis, but not necessarily available in the public domain.

Nonetheless, conducting elite interviews also involved some drawbacks. These especially involved the *credibility* of information provided by some of the interviewees, which needed to be validated through other research techniques, especially the institutional documents.

[695] In deciding the number of the interviews, I was guided by the principle of "point of saturation" in data collection. For great discussions on this issue, see e.g. Sarah Elsie Baker and Rosalind Edwards, *How Many Qualitative Interviews Is Enough? Expert Voices and Early Career Reflections on Sampling and Cases in Qualitative Research* (Southampton: ESRC National Centre for Research Methods, University of Southampton, 2012) <http://eprints.ncrm.ac.uk/2273/> [accessed 10 April 2013].

APPENDIX II: LIST OF INTERVIEWEES

EU

- Douglas Carpenter, Team Leader for relations with the South Caucasus responsible for EaP bilateral relations, European External Action Service, 16.05.2013, Brussels.
- Filip Alexandru Negreanu Arboreanu, Assistant of the MEP Vălean Adina-Ioana in charge of energy, European Parliament, 08.06.2015, Brussels.
- Expert on Turkey, European External Action Service, 21.04.2015, Brussels, (requested anonymity).
- Advisor to the Director, European Commission, DG Energy, 03.05.2013, Brussels (requested anonymity).
- Desk officer, European Commission, DG Energy, 07.05.2013, Brussels (requested anonymity).
- Desk officer, European Commission, DG Energy, 04.06.2015, Brussels (requested anonymity).
- Desk officer in charge of energy issues, European Commission, DG Neighbourhood and Enlargement Negotiations, 26.05.2015, Brussels (requested anonymity).

Turkey

- Selim Kuneralp, Former Turkish Ambassador and Head of the Mission to the EU, 10.04.2015, Brussels.
- Counselor in charge of energy, Mission of Turkey to the EU, 13.04.2015, Brussels (requested anonymity).

Georgia

- Salome Salukvadze, Counselor in charge of EaP bilateral relations, Mission of Georgia to the EU, 24.04.2015, Brussels.
- Teymur Valiyev, Head of Strategy and Innovations, SOCAR Georgia Gas, 23.04.2015, telephone interview.
- Senior diplomat, Mission of Georgia to the EU, 16.04.2015, Brussels (requested anonymity).
- Desk officer, Georgian Ministry of Energy, 03.06.2015, Brussels (requested anonymity).

Azerbaijan

- Rashad Novruz, First Secretary in charge of energy diplomacy, Mission of Azerbaijan to the EU, 03.05.2013, Brussels.
- Officer from SOCAR UK, 28.05.2012, Skype interview (requested anonymity).
- Senior officer from SOCAR Belgium, 29.06.2015, Brussels (requested anonymity).

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