

## **The European Energy Union Project: Chances and Obstacles**

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The concept for an integrated Energy Union has been on the EU agenda for quite a long time. Discussions are being held on both expert and strategic level in parallel with the efforts on the part of EU institutions (above all, the European Commission and the European Parliament) and the Member States (MS) to define the mainstays of a common energy policy. Similarly to foreign policy, energy policy is implemented on the basis of the sovereign will and the national interests of MS. The overall coordination is carried out through the mechanism of intergovernmental consultations within the European Council. The growing geopolitical vulnerability of the EU triggers the process of close European energy collaboration. In the beginning of 2015 the EC elaborated the strategic framework of the future Energy Union, adopted at the European Council meeting in March. Poland, represented by its former Prime Minister and current President of the European Council D. Tusk, is the initiator for the establishment of the European Energy Union.

### ***Energy Union Strategic Framework***

The Strategic Framework covers five interrelated dimensions of energy collaboration across the EU:

- Energy security: this implies diversification of energy supply and routes as well as a more efficient utilization of domestically produced energy within the EU itself;
- A fully integrated European energy market: this implies energy connectedness by means of the establishment of a network of interconnections and market liberalization through the removal of technical and regulatory obstacles. Only thus, according to the strategic document, will energy suppliers operate in a competitive environment and will be forced to offer energy at affordable prices;
- Energy efficiency: to be achieved by fostering moderation of demand because the best energy is the energy saved. Energy efficiency also underpins the concept of sustainable energy. Ultimately, energy efficiency aims at reasonable utilization of internal European energy resources, less environmental pollution and less import from suppliers external to the EU;
- Decarbonising the economy: through the fostering of a well-functioning EU Emissions Trading System, formulation of a common EU position on Paris negotiations in December 2015 with a view to achieving a new binding global climate agreement. Establishment of favourable conditions for investments in renewable energy.
- Financial support for research and innovation: this implies the implementation of joint studies within the EU in the field of low carbon technologies and the provision of funding for public-private partnership projects.

The Strategic Framework relates the integrated energy policy to the other key policies in the spheres of transport, competition, trade, investments, regional development, climate change, scientific research and innovations. This Strategic Framework will remain a mostly non-binding document if its content fails to become more specific. Therefore, the pending debates on the structure, rules and mechanisms that will govern the functioning of the future common energy market, the definition of priorities for the provision of funding for infrastructure components, such as gas transmission networks, interconnection links, gas storage facilities and liquid gas hubs, will be of great importance.

D. Tusk channels the discussions in the European Council towards the assessment of the negative environmental effect of the use of fossil fuels (coal and petroleum) for the generation of

electrical power, which allegedly contributed to the increase of greenhouse gas emissions and global warming. The EC and the majority of MS share a wider point of view, according to which the energy security and competitiveness of the EU will be achieved by means of energy efficiency, low carbon technologies and a functioning integrated energy market. The final text on this issue in the document constitutes a complicated compromise, conceding for the inclusion of the decarbonisation of economy among the priorities of the Energy Union. The MS shall retain their sovereignty over the choice of the energy mix of their national energy systems [including energy from coal, natural gas, nuclear, renewable sources (wind, water and solar power)]. It is agreed that the Energy Union shall be based on the principles of energy and climate security.

The international environmental non-governmental organizations raise concerns about the fact that the debates on the Energy Union focus mainly upon the diversification of gas suppliers and routes rather than upon the promotion of renewable energy and the increase of its share in EU economy. They consider the replacement of Russian gas with Azerbaijani, Turkmen or Qatari gas as a manifestation of geopolitics which contributes in no substantial way to the establishment of an environmentally friendly EU-wide energy sector. The leader in the generation of energy from renewable resources in the EU, Denmark, initiated informal discussions about the benefits from renewable energy for sustainable development of the EU with the representatives of other five MS (Finland, France, the Netherlands, Portugal and Sweden) on the sidelines of a European Council summit. These talks also brought together top managers from leading European companies, specialized in the negation of renewable energy and equipment, such as *Dong Energy, Vestas, EDF, Siemens Wind Power & Renewables*.

In order to strengthen the supranational principle in the governance of energy issues in the EU, the Juncker Commission established a special coordination position. The Slovak diplomat and politician Maroš Šefčovič, who has previous experience in interinstitutional relations the governance of EU administration as European Commissioner, was appointed Vice President and Commissioner for Energy Union in the new EC. The European Commission expects to be granted greater capacity to exercise rights within the formulation of the EU energy policy. This demand is provided for in the Strategic Framework by means of the ambiguous statement concerning the ensuring of appropriate transparency of the contracts for commercial gas supply to European consumers. The EU bureaucrats hope to be granted access to the conditions, envisaged by the gas supply contracts between the MS and Gazprom, as well as other external natural gas suppliers. The EC has launched a conformity assessment of already concluded bilateral intergovernmental agreements of the Russian gas giant with MS after allegations of breach of market competition principles and drastic differences between the gas supply prices agreed in the contracts with a number of MS. Brussels wants to have the decisive say in the pricing of energy supplies for the European market (in other words, to define the price framework of the future gas deals). Thus, the EC will participate in the establishment of the consumer market. Such a model for market relations excludes the undertaking of any responsibility on the part of the end consumer about the prospecting, extraction and transmission of energy resources, yet it provides him with juridical levers for setting the rules of the game in the sphere of natural gas import. At the insistence of Germany, Finland and the Netherlands, the provision, entitling the EC to inspect the contents of the bilateral agreements of MS with external energy suppliers, was omitted in the final text of the Strategic Framework. The main argument was to respect the rule for confidentiality of commercial information, contained in the concluded gas supply contracts. The MS also refuse to grant the EC the exclusive rights for holding the negotiations with external suppliers about natural gas import on the part of the entire EU.

The supporters of the energy efficiency concept seek to impose it as one of the foremost aspects of the future Energy Union. The MS take into account the importance of energy efficiency in terms of managing the electrical energy deficit in certain EU regions. For the first time ever an EU strategic document states the relation between energy efficiency and energy security. The most secure energy, according to M. Šefčovič, is the energy not generated. In his terms, energy efficiency means the rational utilization of available energy capacities and the implementation of energy efficiency measures at the level of the end user (as an example, we can note the programme for the insulation enhancement of residential blocks of flats in Bulgaria).

### ***Geopolitical dimensions of the Energy Union***

According to estimates of the Atlantic Council experts, the EU will retain its position of a large importer of energy resources in the foreseeable future. The overall European import energy market amounts to EUR 400 billion. The economy of the Energy Union will continue to make use of 85% of imported petroleum and petroleum products and of 65% of imported natural gas. The extraction of energy resources within the MS will register an insignificant growth in result of the shrinking investments in the development and exploitation of their own deposits. These estimates are further supported by the geopolitical dynamics of the international energy markets against a backdrop of an abrupt price slump for black gold, occurring ever since the beginning of 2014. The European gas market also tends to shrivel. The consumption of natural gas in the EU in 2014 dropped down by 10 percent. The structure of natural gas imports to the European market is as follows: 42% from the Russian Federation, 38% from Norway, 12% from Algeria, 5% from Qatar and 3% from Nigeria.

### ***Russian – European energy relations***

The major geopolitical challenge is what impact the establishment of the European Energy Union will have on the current condition and future prospects of the Russian – European energy relations. Until now the strategy of the Russian gas giant Gazprom envisaged its involvement in each step along the delivery chain – from the installation and management of gas pipelines on EU territory to the sale of gas to the end users. On a number of occasions Gazprom tried to purchase shares in the national gas transmission networks of the MS. The company's attempts to neutralize the impact of the EU's Third Energy Package (which envisages unbundling energy suppliers from transmission network operators, thus preventing market monopolies) on its own activity on the European energy market have failed. Gazprom was not given the chance to make maximum use of the capacity of Nord Stream gas pipeline in spite of the plans for the construction of a second route with a view to the pipeline capacity expansion. Ultimately, Gazprom decided to give up the construction of energy infrastructure on EU territory and to build gas pipelines that only reach the EU borders. By means of refusing to exercise control over the European energy infrastructure, the Kremlin to all appearances demonstrated willingness to comply with Brussels-imposed rules. Yet, in parallel to that Gazprom announced its decision to terminate the gas transit via the Ukraine after the expiration of the contracts with the EU in 2019. This is the subtlest aspect of the new Kremlin's strategy. Any possible re-routing of the gas transit via Turkey – Greece – FYROM – Serbia – Hungary – Austria will change the geography of Russian – European gas deliveries. Gazprom wishes to force the EU to invest huge amounts into the construction of a new gas transmission network which will handle Russian gas volumes of 30 – 45 billion cubic meters via Turkish Stream. The Kremlin's strategic design envisages the elimination of any dependence on the unpredictable anti-Russian regime of Kiev (i.e. to curb the possible use of this regime as a pressure factor against Russia, which determines the dynamics of

Russian – European energy relations). The Ukraine is the focal point of the current geopolitical clash between the West and Russia. This clash does not even start to look as if it would get solved shortly. The EC remains firmly opposed to Gazprom's plans to redirect gas transit and insists that under the provisions of the current contracts Gazprom must provide gas to the specified places of delivery and make use of the already established routes via the Ukraine. At the same time, we should take note of the fact that the negotiations on the finalization of the Turkish Stream project have not been concluded yet and its future remains unclear against the backdrop of political instability in Turkey. The issues in dispute concern the precision of the coordinates of the inland section of the pipeline across Turkish territory and the discount from Russian gas prices required by Ankara. The technical and financial justification of the proposed pipeline has not been approved yet. The construction of nearly 800 km of the pipeline route on Russian territory to the Black Sea port of Anapa, which is the origin point for the pipeline before it submerges under the Black Sea, still remains to be completed.

In case Turkish Stream project is discontinued Moscow may try to revive the South Stream project under some new form. Most experts from the West view Gazprom's southbound projects as too expensive and risky from an investor's point of view as well as operating mainly as instruments of the Russian geopolitics in the region. At the present stage Gazprom will aim at a quick commercial application of the gas pipelines, manufactured for the needs of the discontinued South Stream project. The pragmatic approach to the establishment of the European Energy Union allows for the possible transmission of Russian gas via Bulgaria to the European gas market as well.

The EU intends to reduce to the minimum the dependency of the European energy market on Russian deliveries in mid- and long-term perspective. This has been made evident by Brussels' strategy for the diversification of the routes, sources and support for the implementation of the Southern Gas Corridor. Meanwhile, the Kremlin strives to preserve Gazprom's share of the European energy market by transporting natural gas along the Nord and the Turkish Stream routes. The authorities in Kiev would also like to retain their strategic position of a transit country while suspending gas purchases from Russia and opting for reverse deliveries from Slovakia, Hungary and Poland.

What should in these circumstances be the way to the restoration of the pragmatic energy cooperation between Brussels and Moscow? The EU has to acquiesce in having Russia retain its position as one of its large energy suppliers in mid-term perspective. Russia in its turn continues to invest in gas exploration and extraction as well as in the construction of gas pipeline infrastructure on its own territory as a prerequisite for boosting its energy export to the EU. It is apprehensive about its rate of return in case its relations with the EU deteriorate further. Moscow demands unequivocal signals from Brussels about energy collaboration prospects and in particular about certain loosening of existing restrictions, imposed by virtue of the Third Energy Package. The EU's Third Energy Package in its current form lacks balance as it caters much more for the interests of the consumers/importers of energy resources than for those of the energy suppliers. Russia in its turn needs to stop using Gazprom as an instrument for the implementation of its geopolitical aims and start developing its energy relations with Brussels on a purely commercial, economic and market basis. Hitherto, the Russian side has failed to offer any transparent, balanced and market-justified pricing formula for its gas deliveries to the European market (for example, there is a considerable difference in the prices for MS from Central and Eastern Europe, on the one hand, and Germany, on the other). Russia will increase the trust the EU and the international energy community have in it if as a first step it provides

partial access to its gas transmission infrastructure to the energy producers from Central Asia so that their export is distributed to third party markets (in particular, the European energy market). This will cause the EU to withdraw some of its claims for the current prevention of external suppliers from transiting their natural gas through the Russian gas pipeline network.

As regards the Ukraine, it should be given the chance for making profit out of gas transit. This is an important factor for sustaining the Ukrainian economy. Yet, both Brussels and Moscow are well aware of the fact that the outdated Ukrainian gas transmission network will require urgent modernization in case they agree on preserving the Ukrainian gas transit share. With a view to the huge investments that need to be made, the successful move would involve the establishment of a trilateral European – Ukrainian – Russian consortium which is to modernize the Ukrainian gas transmission network.

### ***Energy security by means of diversification***

The rapid development of Azerbaijani oil and gas industry after the independence of this strategically important for the EU republic in the South Caucasus gives further impetus to the construction of oil and gas pipelines that bypass Russia. The first breakthrough was the launch of the crude oil pipeline Baku – Tbilisi – Ceyhan in 2006 which transports Kaspian crude oil to the Eastern Mediterranean region where it is loaded onto tankers to reach the European markets. In the same year natural gas deliveries were launched from Shah Deniz I gas field to Turkey along the South Caucasus gas pipeline. Negotiations got started on the Nabucco pipeline project which was meant to supply Azerbaijani gas to the European markets. The poor project management (including the failure to provide the maximum discharge of 31 billion cubic meters and the unclear funding scheme) caused the project to collapse. The Nabucco pipeline project was considered a key element of the energy security of South East European countries which are 90 percent dependent on Russian gas supplies. The state-owned Azerbaijani oil company SOCAR in cooperation with the Turkish oil company BOTAS filled the vacuum by means of launching the Trans-Anatolian Natural Gas Pipeline (TANAP) project which comes as an extension of the South Caucasus Pipeline and is therefore planned to deliver Azerbaijani gas to the Turkish – Greek border. Meanwhile, efforts were made to reanimate Nabucco project by transforming it into Nabucco West (including a gas pipeline along the route Turkey – Bulgaria – Romania – Hungary with a final delivery point at the gas hub at Baumgarten in Austria). Nabucco West was initiated as an extension of TANAP. In its turn, British Petroleum which is the major shareholder in Shah Deniz consortium crushed the above efforts by changing the pipeline route. In 2013 the consortium decided that the Azerbaijani crude oil will be transported to Europe along the Trans Adriatic Pipeline (TAP) along the route Greece – Albania – Italy. This pipeline suits the interests of Greece and the Western Balkans. We should note here that British Petroleum holds a 20 percent share in TANAP project. TAP which is to connect Italy with TANAP will have a capacity of 10 billion cubic meters with the possibility to increase the discharge of up to 20 billion cubic meters after compressor stations are put in place. Rehabilitation of roads which run along the route of TAP pipeline on Albanian territory has been launched. In addition, a gas interconnector (Turkey – Greece – Italy) is also envisaged with a capacity of 5 – 8 billion cubic meters but such a development will leave Greece without any transit quantities for the East Med gas pipeline. The schedules for the construction of TAP and TANAP were finally agreed upon and the expectations are that within 10 years they will transmit 30 billion cubic meters of alternative gas resources from Shah Deniz-II gas field. USD 10 billion have already been spent on the implementation of the above projects. All of the hitherto described gas routes are jointly referred to as the Southern Gas Corridor which, according to experts, aims at curbing Russian

gas domination in South-Eastern Europe. The implementation of the Southern Gas Corridor is an important component of Brussels' strategy for enhancing energy security by means of diversification.

Yet, the Southern Gas Corridor will not be capable of functioning at its full capacity if it relies solely on natural gas from Azerbaijan. The gas reserves of Baku are insufficient for the implementation of these ambitious gas routes. The strategy of the West includes the involvement of Turkmenistan and Iran (in case the relations between Iran and the West continue the trend towards normalization). The transmission of Turkmen gas to the Southern Gas Corridor is planned to be implemented along the proposed Trans-Caspian gas pipeline. The construction of the latter is currently a matter of hypotheses rather than of actual feasibility. The world's second largest gas field - Galkynysh – which holds proven reserves of 21.2 trillion cubic meters of gas is in Turkmenistan. It was opened for production in 2013 after China invested USD 8.1 billion into the construction of the necessary facilities. Turkmenistan exports natural gas to China along the Trans Asia gas pipeline. In 2015 the state-owned Turkmen concern TurkmenGaz signed a memorandum for innovative Japanese investments in the construction of processing plants for the natural gas from Galkynysh field. Turkmenistan gives access to no Western companies to the development and operation of its gas fields. Geopolitically speaking, Russia and China are well positioned in Turkmenistan and hitherto have managed to thwart the attempts of the EU and the US at attracting Ashgabat's attention to the Southern Gas Corridor. As regards Iran, its natural gas will sooner or later also get flowing towards Europe. Yet, the construction of a modern gas transmission network which is to transport fuel gas from South Pars gas field to the Turkish border is still down the road for Teheran. This construction will require considerable time and investment. According to current forecasts, it may be implemented within a period of 10 years. On top of that Iran will also have to resolve the issue of its own economy's low energy efficiency.

Russia is well aware of the consequences that the energy union which is already taking shape will bring about in Central and South-East Europe. Thus Moscow will have to opt for the market-oriented rather than the geopolitical approach to its gas expansion in the EU. Therefore, we should not rule out the possible offer on the part of Gazprom of certain gas volumes for the Southern Gas Corridor. Such a move on the part of Moscow will not be in breach of the European energy legislation. Yet, till the present moment Gazprom has not voiced any such intention. In case the Russian gas monopolist initiates a step in that direction its chances will be slender as it will have to face the bitter competition for access to the corridor on the part of the other bidders at gas delivery tenders.

#### ***The Energy Union in regional context (Central and South-East Europe)***

South-East Europe is turning into a test lab for the implementation of the foremost principle of the European Energy Union – the regional market integration. The latter makes it necessary to find a solution to the lingering issue of interconnector construction. Interconnectors are a relatively inexpensive and quick way to achieve European energy market integration. The establishment of the gas interconnector to link Bulgaria and Greece will cost EUR 200 million of which EUR 4 million come as co-funding from the EU funds. Interconnectors are an important component which ensures the transmission of surplus energy to other gas and electricity networks, thus establishing a common regional electricity and gas market. Renewable energy resources are another option the potential of which is also promoted with a view to the enhancement of liquidity and flexibility of the energy distribution networks. The negotiations and coordination on regional level of the new regulations which are currently being developed by

the EC (such as security and transparency of gas deliveries, the rules for the construction of gas storage facilities, storage and trade in liquefied gas) are still down the road. Meanwhile, the European institutions need to take into account the fact that the market players in Central and South-East Europe interpret the EU energy legislation and regulations in a different way and pursue their energy interests through different negotiation formats. According to the Bulgarian energy expert and former Ambassador-at-Large for Energy Security and Climate Change, it is only right that in the process of elaborating its energy strategies the EC should involve at expert level the national system operators and regulators from the region of South-East Europe. The top down consultations should involve the EC, the European Parliament, the European Network of Transmission System Operators for Gas (ENTSO-G) and the Agency for the Cooperation of Energy Regulators (ACER) while the bottom up consultations should be initiated by the experts from non-governmental organizations. The negotiation process itself should also involve the countries from Central and South-East Europe (as holders of a territorial, infrastructural and commercial share) in the establishment of the regional energy market. Certain asymmetrical sub-regional initiatives (such as a road map for the establishment of a gas market of the Visegrad Group (the Czech Republic, Hungary, Poland, Slovakia), the South – North gas corridor with the participation of Greece, Bulgaria and Romania and/or Bulgaria, Greece and Turkey) can also be launched in parallel. According to Popchev, it is particularly important to avoid a conflict between the sub-regional projects and the concept for an integrated European energy market. The sub-regional initiatives will prove successful if the Ukraine gets invited to the negotiation format in its capacity of a strategic partner for the establishment of a regional gas market in South-East Europe.

#### ***Bulgaria's initiative for a regional gas hub***

Bulgaria initiated the establishment of a gas hub in the vicinity of Varna or at any other entry point on Bulgarian territory of regional gas flows, depending on what their routes may be. Realistically speaking, the establishment of such a hub is only possible if Moscow chooses to switch back in one way or another to the South Stream project. The establishment of an European gas hub on the territory of Bulgaria will necessitate the transformation of the entire national gas transmission system and the construction of gas interconnectors that link the country with its neighbours (Greece, Romania, Greece and Turkey) within a regional gas hub. At national strategic level the Bulgarian Government has coordinated the construction of the interconnectors but very little practical work has been carried out till now. The implementation of the regional gas hub will also necessitate the construction of a large capacity gas storage facility which is several times as large as the existing one in Chiren. The hub is currently envisaged as a regional circular dispatch center with entry and exit points for natural gas trade at the borders of South-East European countries. The strategic framework of the European Energy Union promotes the establishment of liquid gas hubs with the participation of multiple suppliers.

#### ***Liquid gas***

The strategy for liquid gas can be implemented only if it becomes an integral part of the entire energy system of the EU. The US supports the European strategy for liquid gas as they consider it instrumental for the transformation of the global geography of natural gas deliveries. Washington expects Europe to start satisfying a considerable portion of its energy needs by means of importing liquid gas from North America by 2030. In order to achieve this goal, Europe will have to construct liquid gas terminals and large gas storage facilities.

Lithuania and Poland are the leaders among Central and Eastern European countries in terms of the construction of liquid gas terminals. Lithuania put in operation a liquid gas floating storage

unit (which costs EUD 325 million and has the capacity to handle 4 billion cubic meters of gas) and Poland launched a liquid gas terminal (which costs EUD 1 billion and has the capacity to handle 5 billion cubic meters). Vilnius and Warsaw intend to boost delivery security by importing liquid gas from the US. In South-East Europe Greece in its turn plans the construction of two liquid gas terminals (*DEPA* in the port of Thessaloniki with a capacity of 3 – 5 billion cubic meters and *Prometheus Gas* in the vicinity of the port of Alexandroupoli with a capacity of 2.5 billion cubic meters). Croatia plans to construct the liquid gas terminal *Adria* in the vicinity of the isle of Krk in the Adriatic Sea with a capacity of 10 billion cubic meters. Its construction will cost between USD 300 million and 1 billion. Romania is also planning the construction of a liquid gas terminal at Constanta.

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