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# The Agreement on the Dostluk Field and the Outlook for Caspian Energy Security

*Mariana Liakopoulou*  
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## Abstract

This Research Study examines the resolution of the 30-year dispute between Azerbaijan and Turkmenistan over the rights to develop the Dostluk (in Turkmen, “Dostluq”) offshore oil and gas field spanning their subsea zones in the Caspian Sea. It argues that the resolution of this dispute resulted not only from the signature of the Convention on the Legal Status of the Caspian Sea but also from political efforts. Azerbaijan and Turkmenistan compromised so as to further their security of energy demand, as oil- and gas-exporting countries looking to diversify their buyers, for a common longer-term benefit. Finally, the Dostluk deal is treated in the context of the EU’s long-standing efforts to diversify its own sources of gas supply through the Southern Gas Corridor (SGC) pipeline network.

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The Energy Security Program, directed by Dr. Robert M. Cutler ([rmc@alum.mit.edu](mailto:rmc@alum.mit.edu)), is an activity of the NATO Association of Canada, Toronto, a non-profit organization having the mission to keep Canadians informed about the significance of NATO. The Energy Security Program (<http://natoassociation.ca/category/programs/energy-security/>) seeks, in addition, to inform the international policy community on energy-related issues of significance to NATO member-states.

## Executive Summary

This Research Study examines the resolution of the 30-year dispute between Azerbaijan and Turkmenistan over the rights to develop an offshore field spanning the two littoral states' subsea zones in the Caspian Sea. Previously called "Kepez" by Azerbaijan and "Sardar" by Turkmenistan, this field (now by common accord called "Dostluk/Dostluq" meaning "friendship") is estimated to hold some 50-100 million tons (Mt) of oil and some 30 billion cubic metres (bcm) of natural gas. On 21 January 2021, Turkmenistan's President Gurbanguly Berdimuhamedov and Azerbaijan's President Ilham Aliyev had a major breakthrough, prepared between the two sides over several years of high-level consultation, by co-signing a Memorandum of Understanding (MoU) to explore and develop the field jointly.

The August 2018 signature in Aktau, Kazakhstan, of the Convention on the Legal Status of the Caspian Sea ("Aktau Treaty", also "Caspian Convention") by Azerbaijan, Iran, Kazakhstan, Russia, and Turkmenistan catalyzed the settlement of the dispute. The Dostluk MoU resulted not only from a legal but also from a political resolution that was worked out over time, starting with the bilateral MoU on further development of co-operation in the area of energy signed during President Berdimuhamedov's official visit to Azerbaijan in August 2017. Following that political decision to resolve the disagreement, Azerbaijan and Turkmenistan compromised so as to further their security of energy demand, as oil- and gas-exporting countries looking to diversify their buyers, for a common longer-term benefit.

Last, the dispute's resolution is treated in the context of the EU's long-standing efforts to diversify its own sources of gas supply, including the possibility of extending the Southern Gas Corridor (SGC) to the eastern shore of the Caspian Sea. The bilateral disagreement over the Dostluk field was one of the obstacles to the implementation of the prospective Trans-Caspian Gas Pipeline (TCGP) project, which would extend the SGC to Turkmenistan. The Dostluk field is located on the TCGP's prospective route.

The present Research Study unfolds through six sections. A brief outline of the conceptual framework is presented first, followed then by a summary history of the Kepez/Sardar conflict. The third section provides an in-depth discussion of the milestone Dostluk agreement, followed in turn by its evaluation in the context of the legal status of the Caspian Sea following the 2018 signature of the Aktau Treaty. The relevance of these developments for the SGC is clarified on that basis, and a conclusion then follows.

# The Agreement on the Dostluk Field and the Outlook for Caspian Energy Security

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## 1 Conceptual Framework

General definitions of the energy security of both exporting and importing countries frame this work, which treats Europe<sup>1</sup> as a cluster of importing countries and Turkmenistan and Azerbaijan as exporters.<sup>2</sup> Energy security is commonly defined as the uninterrupted availability of reliable energy supplies at affordable prices; however, this definition reflects primarily the perspectives of energy-consuming countries, so it is really “security of energy supply”. It is important to complement this analytical category with that of “security of energy demand”, which takes reflects the perspective of supplier countries. Energy security of demand principally means guarantee of reliable revenues from the final consumer markets. Its significance emerges from the fact that supplier countries often greatly depend on revenues from energy exports.<sup>3</sup>

Three main threats may affect energy security by either disrupting or altogether preventing energy flows. These are: (1) natural causes and technical accidents, (2) economic and political tensions amongst countries, and (3) terrorism and piracy. The second threat is pertinent to the case studied here.

Understanding the history of the Dostluk conflict requires analysis of the once-poor state of relations between Azerbaijan and Turkmenistan, the aggravation of which was significantly due to conflict over which of them would develop the deposit. This conflict is examined also in light of the long-standing, largely geopolitically-driven divergence of views amongst the five Caspian Sea littoral states (the others are Iran, Kazakhstan, and Russia) over the legal status of the Caspian Sea itself. This divergence was finally resolved

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<sup>1</sup> By “Europe” the authors mean not only the Member-States of the European Union (EU) that will be supplied by the European segment of the SGC – i.e., the Trans Adriatic Pipeline (TAP) – but also the Energy Community Contracting Parties (Albania, Bosnia-Herzegovina, Georgia, Kosovo, Moldova, Montenegro, North Macedonia, Serbia, Ukraine) as well as Turkey, an observer to the Energy Community Treaty.

<sup>2</sup> This section is largely based on Fabio Indeo, “Energy security in Central Asia: The Positive Impact of an Improved Regional Cooperation,” paper presented to the Conference, *Non-traditional Risks and Challenges to Central Asian Security*, OSCE Academy, Bishkek, 17–18 May 2018.

<sup>3</sup> Daniel Yergin, “Ensuring Energy Security”, *Foreign Affairs* 85:2 (March–April 2006), 69–82, <<https://doi.org/10.2307/20031912>>.

by the signature of the Convention on the Legal Status of the Caspian Sea in the Kazakhstani city of Aktau (hence the “Aktau Treaty”, also the “Caspian Convention”) in August 2018, after two decades of negotiations.

The Caspian Sea region has long been touted as an additional source of gas supplies for Europe. With the exception of the Southern Gas Corridor (SGC), however, a lack of infrastructure has generally prevented its supplies from reaching European markets. In this context, it is important to highlight four types of dependence that characterize these Caspian Sea countries’ needs for transit routes international markets. These are dependence on transit infrastructure, on international political relations with neighbouring states, on domestic peace and stability within these latter, and on the administrative regulation of the transit flows.<sup>4</sup>

All four types of dependence are pertinent to the examination of the Caspian Sea littoral states, including Azerbaijan and Turkmenistan, on which the focus is put here. These types of dependence complicate, for Baku and Ashgabat, the task of establishing a firm supply relationship with Europe. This is the case all the more, given the cyclicity of Europe’s demand. This cyclicity of demand is in turn at present highly contingent upon the evolution of the epidemiological situation, which varies across the different regions of Europe and over time. Even in the absence of epidemiological considerations, the Caspian Sea region’s supply relationship with Europe would be complicated by the cyclicity in spot prices of liquefied natural gas (LNG). These prices in turn depend upon the availability of surplus cargoes and how tight the market is.

Exporting countries may enhance their security of energy demand by diversifying export routes. Diversifying their end-markets, by developing new energy partnerships that increase competition amongst buyers, also helps to maximize revenues. In the case of Turkmenistan, beyond the motive to diversify export markets, the country’s broader geopolitical situation has impelled it to seek alternative export routes as a strategic goal. Indeed, Turkmenistan’s export reliance on Chinese purchases comes with the risks of monopsonist price-revisions that the sole buyer may seek to impose. Moreover, in such bargaining as may occur, Turkmenistan becomes really a price-taker because it is so dependent on Chinese financial support for developing its upstream and midstream sectors.<sup>5</sup>

Russian and Iranian opposition to the laying of subsea pipelines has complicated the implementation of a westward export route under the Caspian Sea, although Russia has never had a problem with laying pipelines in its own sector of the sea or in Kazakhstan’s

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<sup>4</sup> Michael Faye et al., “The Challenges Facing Landlocked Developing Countries”, *Journal of Human Development* 5:1 (March 2004), 41-43, <<https://doi.org/10.1080/14649880310001660201>>; Azad Garibov, *Trans-Caspian Cooperation: Overcoming the Curse of Landlockedness*, SAM Comments 22 (Baku: Center for Strategic Studies, December 2017), 5, 15-18, available at <[https://www.academia.edu/36894440/Trans\\_Caspian\\_Cooperation\\_Overcoming\\_the\\_Curse\\_of\\_Landlockedness](https://www.academia.edu/36894440/Trans_Caspian_Cooperation_Overcoming_the_Curse_of_Landlockedness)>.

<sup>5</sup> For details, see Mariana Liakopoulou, *New Dimensions of the Great Caspian Energy Game*, Energy Security Program Research Study 1 (Toronto: NATO Association of Canada, August 2020), <<https://natoassociation.ca/new-dimensions-of-the-great-caspian-energy-game/>>.

with the latter's co-operation. The recent agreement between Turkmenistan and Azerbaijan on the joint exploration and development of Dostluk, following on the signature of the Aktau Treaty, may represent an important turning point. It could indeed signal a genuine move towards the real enhancement of energy co-operation across the Caspian Sea region.

The envisioned joint work on the development of Dostluk could promote the resolution of political issues allowing Turkmenistan to link its onshore hydrocarbon reserves (via its domestic East-West Pipeline for natural gas) to an eventual Trans-Caspian Gas Pipeline (TCGP). In August 2019, a year after the signing of the Aktau convention, it was reported that a consortium comprising Germany's Edison Technologies and MMEC Mannesmann GmbH, Air Liquide Global E&C Solutions (France) and the Chinese SINOPEC Engineering Group had expressed its readiness to go ahead with the TCGP project.<sup>6</sup> There have, however, apparently been no further developments of such an initiative since then.

## 2 History of the Kepez/Sardar Conflict

It is believed that the offshore Dostluk oil and gas deposit, called "Kepez" by Azerbaijan and "Sardar" by Turkmenistan prior to the recent rapprochement and a couple of months prior to the signing of the pertinent MoU, holds approximately 50-100 million tons (Mt) of oil<sup>7</sup> and over 30 bcm of natural gas.<sup>8</sup> Both countries have claimed the right to develop it.<sup>9</sup> It also lies along the route of the TCGP project. The field is said to have been originally discovered in 1959 by Azerbaijani geologists.<sup>10</sup> According to Natig Aliyev, former president of the State Oil Company of the Azerbaijani Republic (SOCAR), Azerbaijani oil workers prepared the block for deep exploratory drilling in 1983, and this drilling took place in 1986. According to SOCAR, the first well flowed at a rate of approximately 300 tons per day (equivalent to approximately 1,887 barrels per day) of oil, whilst two subsequent wells also found oil as well as natural gas.<sup>11</sup>

<sup>6</sup> Azad Garibov, "Hopes Reemerge for Trans-Caspian Gas Pipeline, but Critical Obstacles Persist", *Eurasia Daily Monitor* 16:118 (4 September 2019), <<https://jamestown.org/program/hopes-reemerge-for-trans-caspian-gas-pipeline-but-critical-obstacles-persist/>>.

<sup>7</sup> According to older estimates about its oil reserves, the field is believed to contain 150-200 Mt of oil. See: Bertil Nygren, *The Rebuilding of Greater Russia: Putin's Foreign Policy Towards the CIS Countries* (London and New York: Routledge, 2008), 268.

<sup>8</sup> Orkhan Jalilov, "Azerbaijan, Turkmenistan Sign Memorandum on Joint Exploration and Development of Oil Field", *Caspian News*, 23 January 2021, <<https://caspiannews.com/news-detail/azerbaijan-turkmenistan-sign-memorandum-on-joint-exploration-and-development-of-oil-field-2021-1-23-0/>>.

<sup>9</sup> Barbara Janusz-Pawletta, *The Legal Status of the Caspian Sea: Current Challenges and Prospects for Future Development* (Berlin: Springer, 2015), 79.

<sup>10</sup> *Caspian Sea Region*, Independent Studies & Analyses [unnumbered] ([Washington, D.C.]: U.S. Energy Information Administration, 26 August 2013), <[https://www.eia.gov/international/content/analysis/regions\\_of\\_interest/Caspian\\_Sea/caspian\\_sea.pdf](https://www.eia.gov/international/content/analysis/regions_of_interest/Caspian_Sea/caspian_sea.pdf)>.

<sup>11</sup> Natig Aliyev, "Kapaz: SOCAR's Official Statement", *Azerbaijan International* 5:3 (Autumn 1987), 87, available at <[https://www.azer.com/aiweb/categories/magazine/53\\_folder/53\\_articles/53\\_statement.html](https://www.azer.com/aiweb/categories/magazine/53_folder/53_articles/53_statement.html)>.

The field is geologically similar to Azerbaijan's Azeri-Chirag-Deepwater Guneshli (ACG) offshore crude and natural-gas complex. It is, in fact, located very close to the Azeri field of the ACG complex. Oil and gas from ACG as well as from the offshore Shah Deniz field flow through eight subsea pipelines into the BP-operated terminal at Sangachal, Azerbaijan, whence eight pipelines leave the terminal heading westward.<sup>12</sup> This already-existing infrastructure could enable future transit of Dostluk's hydrocarbon resources onshore.<sup>13</sup> According to an older analysis, a small offshore pipeline with a capacity of up to 8 bcm/y might link offshore drilling rigs of Azerbaijan and Turkmenistan to one other, whence to the South Caucasus Pipeline (SCP, also known as Baku-Tbilisi-Erzurum),<sup>14</sup> which is the first segment of the SGC and runs parallel to the Baku-Tbilisi-Ceyhan (BTC) oil export pipeline until diverging westward in eastern Turkey.

In early 1997, Turkmenistan claimed rights over oil reserves from the ACG's Azeri field, and parts of the Chirag field, which it respectively called Osman and Khazar.<sup>15</sup> In reply, Azerbaijan maintained that the fields lie within its own sector of the Caspian Sea. It referred Turkmenistan to the 1970 USSR Oil and Gas Ministry's division of the Caspian seabed into Azerbaijani, Kazakhstani, Russian and Turkmenistani sectors, using the internationally-recognized "median line" principle. Azerbaijan had already signed the so-called "Contract of the Century", for developing the ACG structures, with a BP-led consortium of mainly Western oil companies. Consequently, Azerbaijan rejected Turkmenistan's claims, stating that the companies developing the fields "had studied this issue in detail and would never have signed the contract if there had been any doubt."<sup>16</sup> The first ACG oil, lifted from the Chirag platform in 1997, was exported from Baku to Novorossiisk, the Russian terminal on its Black Sea coast. (This Baku-Novorossiisk pipeline is also called the "northern route".)

The dispute between Azerbaijan and Turkmenistan over the Kepez/Sardar field emerged following an agreement signed 4 July 1997 by SOCAR with the Russian companies Rosneft and Lukoil for the field's development. Upon this, the government in Ashgabat claimed it as lying within Turkmenistan's own territorial waters.<sup>17</sup> Turkmenistan's

<sup>12</sup> BP, "Sangachal terminal", n.d., <[https://www.bp.com/en\\_az/azerbaijan/home/who-we-are/operationsprojects/terminals/sangachal\\_terminal.html](https://www.bp.com/en_az/azerbaijan/home/who-we-are/operationsprojects/terminals/sangachal_terminal.html)>.

<sup>13</sup> Natalia Konarzewska, "The 'Dost[l]uk' Deal: Boosting Pan-Turkic Energy Cooperation", *Turkey Analyst*, 1 June 2021, <<https://turkeyanalyst.org/publications/turkey-analyst-articles/item/666-the-dostluk-deal-boosting-pan-turkic-energy-cooperation.html>>.

<sup>14</sup> Martha Brill Olcott, *Central Asia's Oil and Gas Reserves: To Whom Do They Matter?* (Thun: Emerging Markets Forum, 23–25 January 2010), 9, <[http://www.emergingmarketsforum.org/wp-content/uploads/pdf/2010\\_EMF\\_Eurasia\\_Olcott\\_Oil\\_and\\_Gas\\_Reserves.pdf](http://www.emergingmarketsforum.org/wp-content/uploads/pdf/2010_EMF_Eurasia_Olcott_Oil_and_Gas_Reserves.pdf)>.

<sup>15</sup> Gulnara Ismayilova and Nailia Sohbetqizi, "Diplomatic Tensions Between Azerbaijan and Turkmenistan", *Central Asia–Caucasus Analyst*, 20 June 2001, <<https://www.cacianalyst.org/publications/field-reports/item/7357-field-reports-caci-analyst-2001-6-20-art-7357.html>>.

<sup>16</sup> Ali Granmayeh, "Legal history of the Caspian Sea", in *The Caspian: Politics, Energy and Security*, edited by Shirin Akiner (London and New York: RoutledgeCurzon, 2004), 22.

<sup>17</sup> Richard M. Levine, "The Mineral Industry of Turkmenistan," in *Area reports – International – Europe and Central Eurasia: U.S. Geological Survey Minerals Yearbook 1997*, vol. 3 (Washington, D.C.: U.S. Government Printing Office, 2013), QQ5.

President Saparmurat Niyazov eventually induced Russia's President Boris Yeltsin to annul the deal, as the Russian Foreign Ministry overruled the commercial interests of the Rosneft and Lukoil.<sup>18</sup> In September 1997, Turkmenistan listed Kepez/Sardar amongst its first round of international tenders aiming at the development of its Caspian shelf. In reply, Azerbaijan threatened to impose sanctions on any company that bid on the disputed field. The US oil company Mobil won the right to develop the field in June 1998, but then announced that it would not begin work until the two countries settled their dispute.<sup>19</sup> By the spring of 1999, this conflict had become the main outstanding issue in relations between Azerbaijan and Turkmenistan. The US, whilst insisting that the Azeri and Chirag oil fields were indisputably Azerbaijan's, tried unsuccessfully to mediate a settlement.<sup>20</sup>

Turkmenistan rejected any reference to the Soviet ministry's 1970 division of the seabed, which would have left the fields in question under Baku's jurisdiction.<sup>21</sup> In fact, in international law, the Soviet ministry's decision was a domestic administrative act without probative value. Turkmenistan further rejected the ministry's use of the method of delineation by median line. Turkmenistan argued that Azerbaijan's territory of Absheron, being a peninsula, should not be considered to influence the delineation; on that basis, Kepez/Sardar and the eastern part of ACG would fall within jurisdiction that Turkmenistan claimed.<sup>22</sup> Turkmenistan's proposed method of delineation involved measurement of the equidistant point from land along successive lines of latitude, whilst the "conventional approach" for this particular method, which is one of several that could be used, would have been "to measure the equidistant point from the closest point of land, regardless of latitude or longitude."<sup>23</sup> Azerbaijan's method would have calculated the median line from SOCAR's artificially-constructed offshore Oil Rocks hub for communications and infrastructure in its own coastal waters of Baku. Azerbaijan would have considered Oil Rocks to be an island, whence it would follow, according to Baku, that Kepez/Sardar was in Azerbaijani waters.<sup>24</sup> In 2000, Turkmenistan announced in a letter to

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<sup>18</sup> R. Hrair Dekmejian and Hovann H. Simonian, *Troubled Waters: The Geopolitics of the Caspian Region* (London and New York: I.B. Tauris, 2003), 94.

<sup>19</sup> Global Investment and Business Center USA, *Turkmenistan: Export-Import and Business Directory*, vol. 1, *Strategic Information and Contacts* (Washington, D.C.: USA International Business Publications, 2013), 31.

<sup>20</sup> Robert M. Cutler, "Azerbaijan vs. Turkmenistan: The Caspian Offshore Oil and Gas Conflict", *Central Asia-Caucasus Analyst* 2:2 (19 January 2000), 5-6, available at [http://www.robertcutler.org/blog/2000/01/azerbaijan\\_vs\\_turkmenistan\\_the.html](http://www.robertcutler.org/blog/2000/01/azerbaijan_vs_turkmenistan_the.html).

<sup>21</sup> Azad Garibov, "Are the Littoral States Close to Signing an Agreement on the Legal Status of the Caspian Sea?", *Natural Gas World*, 16 May 2017, <https://www.naturalgasworld.com/ggp-littoral-states-agreement-legal-status-caspian-sea-37587>.

<sup>22</sup> Svante E. Cornell, *Azerbaijan Since Independence* (London and New York: Routledge, 2011), 223.

<sup>23</sup> Bud Coote, *The Caspian Sea and Southern Gas Corridor: A View from Russia*. (Washington, D.C.: Global Energy Center, Atlantic Council, April 2017), 22, <https://www.atlanticcouncil.org/in-depth-research-reports/report/the-caspian-sea-and-southern-gas-corridor/>.

<sup>24</sup> Cornell, *Azerbaijan Since Independence*, 223.

the United Nations that the division of the Caspian seabed into national sectors would be acceptable to Ashgabat if the interests of all littoral states were taken into account.<sup>25</sup>

The West has been concerned about strained ties between Azerbaijan and Turkmenistan over Kepez/Sardar insofar as these prevented the implementation of the TCGP pipeline.<sup>26</sup> In 2009, Turkmenistan's President Gurbanguly Berdimuhamedov evoked the possibility of going to the International Court of Justice to settle the boundary dispute.<sup>27</sup> Mediation by the European Commission (EC), which co-ordinated talks in Vienna by mid-level delegations from Azerbaijan and Turkmenistan in late 2010,<sup>28</sup> was aimed not just at resuscitating the moribund Nabucco gas pipeline project, but also at resolving the Azerbaijan-Turkmenistan disagreement over the disputed field.<sup>29</sup> Notwithstanding a US-brokered bilateral agreement dating from 2008, which committed the two sides to refrain from geological prospecting and exploratory works on the field until the ownership dispute was resolved,<sup>30</sup> in 2012 Turkmenistan sent a vessel into the field for exploratory work. The Azerbaijani border service detained it.<sup>31</sup>

### 3 The Dostluk "Milestone"

The years following 2012 saw increased tensions, but Azerbaijan and Turkmenistan seemed to reach an understanding that diversifying Turkmenistan's gas export routes to the West would benefit both countries' energy-security profiles. They also seemed to realize that resolving the question between themselves was more advantageous than depending on third-party diplomatic mediation.

In the meantime, Ashgabat had become nearly entirely dependent on exports to China via the Central Asia–China Gas Pipeline (CACG). These exports skyrocketed to 80

<sup>25</sup> Emilia Ramazanova, "The Caspian Sea: Legal Challenges of Delimitation between Littoral States." Master's thesis (University of Tromsø, 2012), 24, <https://munin.uit.no/bitstream/handle/10037/5116/thesis.pdf?sequence=2>.

<sup>26</sup> European Commission, "Gas pipeline to the EU from Turkmenistan and Azerbaijan, via Georgia and Turkey, [currently *sic*] known as the combination of 'Trans-Caspian Gas Pipeline' (TCP), 'South-Caucasus Pipeline Future Expansion' (SCPFEX)", "Last Update June 2021", [https://ec.europa.eu/energy/maps/pci\\_fiches/PciFiche\\_7.1.1.pdf](https://ec.europa.eu/energy/maps/pci_fiches/PciFiche_7.1.1.pdf).

<sup>27</sup> Tracey German, "Energy Exploration and the Caspian Region: Sturgeon, Seals and Sulfur", in *Environmental Crises in Central Asia: From Steppes to Seas, From Desserts to Glaciers*, edited by Eric Freedman and Mark Neuzil (New York: Routledge, 2016), 43.

<sup>28</sup> "EU Facilitates Azeri-Turkmen Talks on Kyapaz/Serdar to Boost Nabucco", *Middle East Economic Survey* 53:39 (27 September 2010), <http://archives.mees.com/issues/65/articles/2455>.

<sup>29</sup> Gulmira Rzayeva and Theodoros G.R. Tsakiris, *Strategic Imperative: Azerbaijani Gas Strategy and the EU's Southern Gas Corridor*. (Baku: SAM Center for Strategic Studies, 2012), available at <http://eliamep.gr/wp-content/uploads/2012/08/tsakiris.pdf>.

<sup>30</sup> Faig Galib Abbasov, "EU's External Energy Governance: A Multidimensional Analysis of the Southern Gas Corridor", *Energy Policy* 65:2 (February 2014), 27–36, <https://doi.org/10.1016/j.enpol.2013.10.007>.

<sup>31</sup> Matthew Kupfer, "Azerbaijan-Turkmenistan: Energy Cooperation or Competition?", *Eurasianet*, 10 August 2017, <http://www.eurasianet.org/node/84686>.



percent of Turkmenistan's overall exports in 2015, almost all of it natural gas.<sup>32</sup> This dependence created the risk of enhancing China's influence in the process of setting the (still undisclosed) purchase price for Caspian and Central Asian gas via CACG. Bargaining over this would be affected by China's funding not just of CACG's Line D but also its funding of the second-stage development of CACG's resource base, the supergiant Galkynysh (formerly South Yoloton) gas field in eastern Turkmenistan. Indeed, the China National Petroleum Corporation (CNPC) recently won an international tender issued by Turkmenistan for the construction of three wells at the Galkynysh field under a service contract, in exchange for up to 51 bcm/y of gas from Turkmenistan.<sup>33</sup>

In 2019, Russia decided to restart imports of natural gas from Turkmenistan in relatively small quantities. The agreed level was 5.5 bcm/y, although actual imports in 2020 were only 3.8 bcm.<sup>34</sup> Although such a small quantity signalled the possibility of a certain degree of geopolitical rapprochement between Russia and Turkmenistan, it could not respond to the latter's wish to expand its diversification of exports away from China. According to Moscow's ambassador in Ashgabat, Russian imports in 2021 were almost 10 bcm, although Turkmenistan has not confirmed this.<sup>35</sup>

Against this backdrop, Azerbaijan and Turkmenistan had attempted a political rapprochement even before the signing the Aktau Treaty in August 2018. The two heads of government signed an MoU on further development of co-operation in the energy sector during President Berdimuhamedov's official 2017 visit to Azerbaijan.<sup>36</sup> The document did not specifically mention either the Kepez/Sardar field or the TCGP, but Turkmenistan soon afterward sought Azerbaijan's collaboration in the Galkynysh-associated Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline project. This gesture was a demonstrable sign of the good will that foretold the agreement on Dostluk.<sup>37</sup> Legal uncertainties are easier to overcome, or even simply to disregard, when financial interests take the upper hand.

An electronically-mediated meeting between the two presidents on 21 January 2021 resulted in the signing, by their foreign ministers, of an MoU on the joint exploration, development, and production of Dostluk's hydrocarbon resources. President Berdimuhamedov stated that the decision to name the field Dostluk/Dostluq (the first

<sup>32</sup> Uuriintuya Batsaikhan and Marek Dabrowski, *Central Asia at 25*, Policy Contribution 13 (Brussels: Bruegel, May 2017), 8, <<https://www.bruegel.org/2017/05/central-asia-at-25/>>.

<sup>33</sup> Marat Gurt, Chen Aizhu, and Muyu Xu, "China's CNPC secures more Turkmen gas in new deal – source", *Reuters*, 24 August 2021, <<https://www.reuters.com/world/middle-east/chinas-cnpc-secures-51-bcm-turkmen-gas-new-deal-says-source-2021-08-23/>>.

<sup>34</sup> BP [formerly British Petroleum], *Statistical Review of World Energy 2021*, 70th ed. (London: BP, 2021), 45, <<https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2021-full-report.pdf>>.

<sup>35</sup> "Russia Doubled Imports of Natural Gas from Turkmenistan in 2021, Envoy Says", *Radio Free Europe/Radio Liberty*, 24 December 2021, <<https://www.rferl.org/a/russia-doubles-gas-imports-turkmenistan/31625051.html>>.

<sup>36</sup> Elmira Tariverdiyeva, "Ashgabat, Baku to expand energy co-op", *Trend*, 8 August 2017, <<https://en.trend.az/azerbaijan/business/2785131.html>>.

<sup>37</sup> Alex Teddy, "Azerbaijan assists Turkmenistan's TAPI pipeline", *Global Source Partners*, 28 November 2018, <<https://www.globalsourcepartners.com/posts/azerbaijan-assists-turkmenistan-s-tapi-pipeline/teaser>>.

meaning “friendship” in Azerbaijani, as the latter does in Turkmen) constituted a “reciprocal resolution” and noted that the “milestone” document resulted from “multiyear work ... aimed at strengthening cooperation and mutual understanding in the energy sphere ... and at establishing a mutually beneficial energy partnership in the Caspian Sea region.”<sup>38</sup>

Turkmenistan’s parliament (Mejlis) ratified the agreement in February 2021 and Azerbaijan’s (Milli Majlis) a month later.<sup>39</sup> The MoU provides that the field’s resources should be apportioned 30 percent to Azerbaijan and 70 percent to Turkmenistan, whilst the two countries would together determine its geographical co-ordinates for the purpose of joint exploration and development.<sup>40</sup> The allocated proportions reflect Azerbaijan’s ability to offer existing infrastructure for transiting the field’s resources to markets in Turkey and Europe. This infrastructure is the SGC, which Azerbaijan initiated and financed, with loans from international financial institutions including, but not only, the European Investment Bank and the European Bank for Reconstruction and Development.<sup>41</sup> A joint working group has been set up and has already held its first meeting for supervising the bilateral MoU’s implementation.<sup>42</sup> According to SOCAR’s Deputy Vice-President of SOCAR for Investments and Marketing, Dr. Vitaliy Baylarbayov, “it is reasonable to assess that within three to five years of the final agreement between the sides, production will commence.”<sup>43</sup>

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<sup>38</sup> Ministry of Foreign Affairs of Turkmenistan, “Meeting of the Presidents of Turkmenistan and Azerbaijan”, n.d., <<https://www.mfa.gov.tm/en/news/2449>>.

<sup>39</sup> Ministry of Petroleum and Mineral Resources of Turkmenistan, “Parlament Azerbaidzhana utverdil memorandum s Turkmenistanom na razrabotku mestorozhdeniia ‘Dostluk’ na Kaspii” [The Parliament of Azerbaijan Approved the Memorandum with Turkmenistan on Development of the “Dostluk” field in the Caspian Sea], 24 February 2021, <<https://oilgas.gov.tm/ru/posts/news/1695/parlament-azerbaydzhana-utverdil-memorandum-s-turkmenistanom-na-razrabotku-mestorozhdeniya-dostluk-na-kaspii>>; “Medzlis Turkmenistana ratifitsiroval memorandum o sovместnoi s Azerbaidzhanom razrabotke mestorozhdeniia ‘Dostluk’” [The Mejlis of Turkmenistan Ratified the Memorandum on Joint Development of the “Dostluk” Field with Azerbaijan], *Khronika Turmenistana*, 15 March 2021, <<https://www.hronikatm.com/2021/03/dostluk-ratification/>>.

<sup>40</sup> “Shares of Turkmenistan and Azerbaijan in Dostluk Hydrocarbon Field Revealed”, *Business Turkmenistan*, 12 February 2021, <<https://business.com.tm/post/6700/shares-of-turkmenistan-and-azerbaijan-in-dostluk-hydrocarbon-field-revealed>>.

<sup>41</sup> A 2014 Azerbaijani presidential decree created SGC CJSC – a joint venture of SOCAR (49%) and the Ministry of Economy of the Republic of Azerbaijan (51%) – as a special purpose company for consolidating, managing and financing the state’s interests in the development of Shah Deniz gas-condensate field, the expansion of the South Caucasus Pipeline and the implementation of TANAP and TAP projects. CJSC has undertaken the project-financing aspect whilst SOCAR provides operational management. According to Fitch, the company’s funding comes from a combination of USD 6.5 billion debt and USD 2.4 billion equity injections from the state. For more information, see “Fitch Affirms Southern Gas Corridor CJSC’s Senior Unsecured Debt at ‘BB+’”, *Fitch Ratings*, 4 March 2021, <<https://www.fitchratings.com/research/international-public-finance/fitch-affirms-southern-gas-corridor-cjsc-senior-unsecured-debt-at-bb-04-03-2021>>.

<sup>42</sup> Nataliya Abassova, “Glava Minenergo Azerbaidzhana obsuzhdaet v Ashkhabade razrabotku mestorozhdeniia Dostluk na Kaspii” [The Head of Azerbaijan’s Energy Ministry Is Discussing the Development of the Caspian Sea’s Dostluk Field in Ashgabat], *Interfax*, 29 July 2021, <<http://interfax.az/view/841030>>.

<sup>43</sup> Vitaliy Baylarbayov, “Azerbaijan’s SOCAR eyes expansion as gas to remain important”, interview by Aura Sabadus, *Independent Commodity Intelligence Services*, 14 September 2021, <<https://www.icis.com/>>.

Roughly a month after the MoU on Dostluk, Vagit Alekperov, the head of Lukoil, met with President Berdimuhamedov and expressed his company's interest in becoming operator of the project: over 20 years after the 1997 agreement with Rosneft and SOCAR was annulled.<sup>44</sup> Lukoil is the biggest oil producer in the Russian sector of the Caspian Sea. It is a shareholder in both the ACG and Shah Deniz consortia. Since 2003,<sup>45</sup> the company has discovered eight oil and gas fields and 16 potential structures in the northern Caspian Sea, with total projected reserves of about 260 Mt of oil and 55 bcm of gas.<sup>46</sup> In 2020, the total oil and condensate production of the company's Vladimir Filanovsky and Yury Korchagin fields in the Caspian Sea was 7.4 Mt. The shipyards at Valery Grayfer field are constructing the platforms as part of Lukoil's third project.<sup>47</sup>

Lukoil now seeks actively to expand its resource base in the Caspian Sea. After the Russian state administration decided to scrap existing tax privileges for greenfield projects for heavy and viscous oil, in a bid to increase budget revenues that declined sharply last year following the fall in international oil prices, Lukoil has sought to convince them to provide tax incentives that would stimulate investment activity in the Caspian Sea.<sup>48</sup>

Lukoil is also setting its eyes on projects situated in the sectors of littoral states other than Russia, whereas Western-based oil companies have become rather more cautious about investing in the region. For example, following Kazakhstan's most recent tax code amendments, Lukoil has boosted its co-operation with KazMunaiGas through such projects as the Al-Farabi, Kalamkas-More, and Khazar structures.<sup>49</sup> Lukoil's interest in pursuing

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[explore/resources/news/2021/09/14/10684255/azerbaijan-s-socar-eyes-expansion-as-gas-to-remain-important/](https://www.energen.com/explore/resources/news/2021/09/14/10684255/azerbaijan-s-socar-eyes-expansion-as-gas-to-remain-important/).

<sup>44</sup> "Lukoil' rasschitivaet stat' operatorom proekta Dostluk na shel'fe Caspiia" ["Lukoil" expects to Become the Operator of the Dostluk Project on the Caspian Shelf], *Tass*, 3 July 2021, <https://tass.ru/ekonomika/11554891>.

<sup>45</sup> In 1997, Kazakhstan and Azerbaijan came to terms with one another about the borders of their respective sectors of the Caspian Sea along the median line. That was a provisional agreement pending a common agreement on the legal status of the Caspian Sea. Kazakhstan and Turkmenistan also signed a communiqué pledging to a division based on the median line. In 1998, Russia and Kazakhstan agreed to delimit their subsea Caspian natural-resource sectors, and Russia and Azerbaijan reached their bilateral agreement on this in 2001. The three countries formalized the division in 2003 when Russia, Kazakhstan and Azerbaijan signed a trilateral agreement that integrated those provisions.

<sup>46</sup> Stanislav Pritchkin, "Russia's Caspian Policy", *Russian Analytical Digest* 235 (18 April 2019), <https://css.ethz.ch/content/dam/ethz/special-interest/gess/cis/center-for-securities-studies/pdfs/RAD235.pdf>.

<sup>47</sup> "PJSC LUKOIL (LUKOY) CEO Vagit Alekperov on Q4 2020 Results - Earnings Call Transcript", *Seeking Alpha*, 17 March 2021, <https://seekingalpha.com/article/4414623-pjsc-lukoil-lukoy-ceo-vagit-alekperov-on-q4-2020-results-earnings-call-transcript>.

<sup>48</sup> Elena Alifirova and Olga Bakhtina, "Pravitel'stvu RF mozhet byt' porucheno razrabotat' stimuly dlia neftedobychy na shel'fe kaspiiskogo moria" [The Russian Government May Be Instructed to Develop Incentives for Oil Production on the Shelf of the Caspian Sea], *Neftegaz*, 22 March 2021, <https://neftgaz.ru/news/gosreg/672157-pravitelstvu-rf-mozhet-byt-porucheno-razrabotat-stimuly-dlya-neftedobychi-na-shelfe-kaspiyskogo-morya/>.

<sup>49</sup> "Podpisan protokol priamykh peregovorov po proektu Al'-Farabi" [The Protocol of Direct Negotiations on the Al-Farabi Project Was Signed]. *Novosti KMG*, 16 March 2021, <https://www.kmg.kz/rus/press-centr/press-relizy/?cid=0&rid=820>

involvement in Dostluk falls into the profile of this strategy of expanding its Caspian-region portfolio.

Turkey declared its readiness to assist in delivering Turkmenistan's gas to Europe during a trilateral meeting amongst Turkmenistan's foreign minister Rashid Meredov and his Turkish and Azerbaijani counterparts, Mevlut Cavusoglu and Jeyhun Bayramov, held in Ankara in February 2021.<sup>50</sup> Turkey's President Recep Tayyip Erdogan had previously invited Turkmenistan's President Berdimuhamedov to the opening ceremony of TANAP in summer 2018.<sup>51</sup> This occurred at about the time when Azerbaijan's President Ilham Aliyev, at a joint press conference with German Chancellor Angela Merkel, declared again his readiness to transit gas from the Caspian Sea's eastern shore. At the same time, he stressed that the TCGP's construction should depend primarily on the interest of the country owning the gas reserves (i.e., Turkmenistan), instead being a joint initiative of all transit countries.<sup>52</sup> In fall 2018, President Aliyev paid a working visit to Ashgabat that resulted in signature, with his Turkmenistani counterpart President Berdimuhamedov, of a package of 20 documents in the areas of transport and energy, further strengthening bilateral cooperation.

Overall, we may say that although the viability of greenfield upstream and midstream projects in the Caspian Sea region remains contingent on commodity prices, which remain quite volatile, and on stiff competition amongst both pipeline and LNG suppliers seeking to satisfy Europe's gas demand, nevertheless the rapprochement between Azerbaijan and Turkmenistan over Dostluk has stimulated a deeper and geopolitically important level of regional cooperation, including but not limited to the energy sector and involving multiple actors in the region. The agreement between Turkey, Azerbaijan and Turkmenistan on the shipping of 1 Mt/y of Turkmen oil, via the BTC oil pipeline as from October 2021,<sup>53</sup> is an indicator of the emergence of deeper geoeconomic and geopolitical relations between Azerbaijan and Turkmenistan, with the support of other regional actors. In addition to the cooperation in the energy sphere, the Azerbaijan-Turkmenistan rapprochement has also allowed the launch and the development of the Lapis Lazuli trade corridor. This corridor starts at the Turkmenistan's border with Afghanistan at Torghundi in Herat province, then crosses Turkmenistan to reach the Turkmenbashi International Sea

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<sup>50</sup> Ministry of Foreign Affairs of Turkmenistan, "Trilateral Meeting of the Heads of the Foreign Policy Agencies of Turkmenistan, Azerbaijan and Turkey Held in Ankara", n.d., <https://www.mfa.gov.tm/en/news/2482>

<sup>51</sup> "Erdogan priglasi Berdimukhamedova na otkritie gazoprovoda TANAP" [Erdogan Invited Berdimuhamedov to the Opening of the TANAP Gas Pipeline], *Prime Business News Agency*, 2 June 2018, <https://1prime.ru/energy/20180602/828894219.html>

<sup>52</sup> Ilgar Gurbanov, "Caspian Convention Signing and the Implications for the Trans-Caspian Gas Pipeline", *Eurasia Daily Monitor* 15:127 (12 September 2018), <https://jamestown.org/program/caspian-convention-signing-and-the-implications-for-the-trans-caspian-gas-pipeline/>

<sup>53</sup> "SOCAR and Vitol to transport Turkmen oil via BTC pipeline", *Turkmenportal*, 13 September 2021, <https://turkmenportal.com/en/blog/39637/socar-and-vitol-to-transport-turkmen-oil-via-btc-pipeline>.

Port. Goods reaching there are delivered across the Caspian Sea to the Baku International Sea Port, then transit through Tbilisi to Ankara and Istanbul.<sup>54</sup>

On 16 January 2021, Afghanistan, Azerbaijan, and Turkmenistan, agreed on a tripartite road-map for deeper cooperation on the Lapis Lazuli Corridor.<sup>55</sup> The terms of the agreement may of course be revised following the mid-August seizure of power by the Taliban in Kabul. The implementation of the project would require guarantees of stability and security.

## 4 The Legal Status of the Caspian Sea

So long as legal regime of the Caspian Sea remained undefined, it created high political risk deterring investment in such disputed fields as Kepez/Sardar. It is therefore useful to recall a few key points in the history of the definition of the legal status of the Caspian Sea. These help to illuminate the state of play regarding the laying of undersea pipelines and cables following the August 2018 signature of the Caspian Convention.

Before 1992, the Caspian Sea was regulated by three treaties, the first signed in 1921 by Persia and the Russian Soviet Federated Socialist Republic (the USSR was not established until 1922), and the other two signed in 1935 and 1940 between Iran and the USSR. The latter two treaties defined the Caspian as a “joint Soviet and Iranian sea.” None of these treaties established any maritime boundary between the two states. These three treaties, taken together, established only one geographical zone where the use of resources was controlled. This was a coastal-waters zone. Each state had the right to fish in its coastal waters up to a limit of 10 nautical miles, but even this zone was not defined as a fisheries zone or a territorial sea under law. None of these agreements referred to division of rights to exploit resources in the continental shelf or to other subsea resources.<sup>56</sup>

In the early 1990s, three legal frameworks appeared possible. The first was a “joint use” framework based on the Soviet successor states having bound themselves to respect the terms of the 1940 treaty through a document on general treaty fulfilment signed at the 10 March 1992 summit of the Participating-States of the Commonwealth of Independent States. The problem was that even the limited regime established by that treaty did not take into account the existence of five littoral states. So Russia, supported by Iran, proposed to

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<sup>54</sup> Fabio Indeo, “New Trends in Central Asia Connectivity”, in *Monitoring Central Asia and Caspian Area*, edited by C. Frappi and F. Indeo (Venice: Ca Foscari Edition, 2019), 74–75.

<sup>55</sup> Naghi Ahmadov, “Azerbaijan, Afghanistan and Turkmenistan Sign Trilateral Roadmap for Cooperation on Eurasian Connectivity”, *Eurasia Daily Monitor* 18:23 (10 February 2021), <<https://jamestown.org/program/azerbaijan-afghanistan-and-turkmenistan-sign-trilateral-roadmap-for-cooperation-on-eurasian-connectivity/>>.

<sup>56</sup> This section adapts material from Robert M. Cutler, “Developments in the Evolving Caspian Legal Regime”, *FSU Oil & Gas Monitor*, published in two parts: No. 96 (22 August 2000), 4–6, and No. 97 (29 August 2000), 4–6; available at <[http://www.robertcutler.org/blog/2000/08/developments\\_in\\_the\\_evolution\\_c.html](http://www.robertcutler.org/blog/2000/08/developments_in_the_evolution_c.html)> and <[http://www.robertcutler.org/blog/2000/08/developments\\_in\\_the\\_evolution\\_c\\_1.html](http://www.robertcutler.org/blog/2000/08/developments_in_the_evolution_c_1.html)>.

define the entire Caspian and its resources as being subject to a “joint use” regime (which is not the same as its being a “joint sea” in international law).

The second possible legal status for the Caspian Sea was as an “international sea” located between independent states, in which case 1958 and 1982 Law of the Sea Conventions would apply. This framework would not have provided for how to allocate natural resources or for what kind of regime to apply outside national territorial waters extending to 12 nautical miles (nm) plus the waters of the national Exclusive Economic Zone (an additional 24 nm). Under this status, the Caspian Sea must be navigably linked to other seas; it was potentially problematic that the Volga-Don Canal, which connects it to the Sea of Azov (an inlet of the Black Sea) is not a salt-water channel. Further, under this status, Kazakhstan could have claimed free passage to the Baltic Sea via Volga-Baltic Sea Canal and the Volga-Aktobe delta.

The third possibility was to consider the Caspian as an “inland lake.” Under international law, this would mean that no coastal state could take any unilateral action or establish national control over seabed resources without the agreement of all the others. Any national sectors eventually delimited would be under the absolute sovereignty of the given coastal state, and no rights of innocent passage would be guaranteed unless expressly agreed.

Under the Aktau Treaty, the Caspian Sea is neither an “international sea” nor an “inland lake”.<sup>57</sup> Its *sui generis* status instead provides for division of the seabed into national sectors, whilst a separate regulation governs the exploitation of Caspian Sea water resources, the latter being divided amongst the categories of national territorial waters, exclusive fishing zones, and shared waterways that all littoral states may freely use.<sup>58</sup> The treaty provides that delimitations of national sectors shall be agreed by the states concerned. Azerbaijan, Kazakhstan, and Russia reached a trilateral agreement in 2004 on the basis of three bilateral accords. The delimitation of national sectors in the southern Caspian Sea is not yet formally agreed.

Article 14(3) of the Aktau Treaty establishes the right of any two states to lay pipelines and cables on the seabed across adjacent sectors, without requiring consent from third-party littoral states. The treaty also calls down provisions of the 2003 Framework Convention for the Protection of the Marine Environment of the Caspian Sea (“Tehran Convention”), including its 2018 Protocol on Environmental Impact Assessment in a Trans-boundary Context (“Moscow Protocol”). The Aktau Treaty provides that third-party littoral states should be informed of such projects and have the opportunity to offer comments on possible environmental effect on their territory in a timely manner, but that they are unable to veto a final decision, which rests exclusively with the states proposing the construction. As Cutler explains:

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<sup>57</sup> Elena Karataeva, “The Convention on the Legal Status of the Caspian Sea: The Final Answer or an Interim Solution to the Caspian Question?”, *The International Journal of Marine and Coastal Law*, 35:2 (2020), 232–63, <<https://doi.org/10.1163/15718085-23521089>>.

<sup>58</sup> Jonathan Stevenson, “The Caspian Sea Treaty”, *Strategic Comments* 24: (2018), i–ii, <<https://doi.org/10.1080/13567888.2018.1557841>>.

The Moscow Protocol to the Tehran Convention provides (Article 10 and 1(a)) that the decision on implementation of any project shall be taken by the “Party(ies) under whose jurisdiction the proposed activity ... is planned to be implemented.” That is to say, the decision is not subject to five-way approval. Therefore, it is impossible for any littoral state to block any project with a simple veto, even in the theoretical case where there are multiple vetoes.

Further, Article 15 of the Moscow Protocol to the Tehran Convention states that “[a]ny dispute between the Contracting Parties concerning the application or interpretation of the provisions of this Protocol shall be settled in accordance with Article 30 of the [Tehran] Convention”, which in turn states that “the Contracting Parties will settle [disputes] by consultations, negotiations or by any other peaceful means of their own choice.”<sup>59</sup>

The Aktau Treaty in combination with Azerbaijan’s and Turkmenistan’s political rapprochement on Dostluk, gradually crafted since 2017, thus prefigure and incentivize stronger cooperation amongst the littoral states. Cooperation at the regional level is key for the creation of geopolitically favourable conditions for the potential materialization of an eastward extension of the SGC, as envisioned in the EC’s diversification strategy dating back over a dozen years.<sup>60</sup> The Russian company Lukoil has implicated itself more strongly in the Caspian Sea during autumn 2021. Aside from its interest in becoming operator of the Dostluk consortium, it has also bought out Petronas’s share of the Shah Deniz Two consortium.<sup>61</sup> Whether future European gas demand and the need for additional import capacity ultimately enable the expansion of the SGC pipeline network as a whole remains to be seen.<sup>62</sup> Other determining circumstances will be the economics of upstream and midstream development projects and the impact on wholesale gas prices of gas storage levels in the EU, the price premium of Asian gas markets, and the availability of market interest.

## 5 The Relevance for the Southern Gas Corridor

SOCAR’s vice-president for investments and marketing, Elshad Nassirov, referred to the resolution of the 30-year dispute with Turkmenistan as a “new cooperation that will open

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<sup>59</sup> Robert M. Cutler, “The Caspian Convention and Caspian Energy”, *Energy Security* (Toronto: NATO Association of Canada, 14 August 2018), <<https://natoassociation.ca/the-caspian-convention-and-caspian-energy/>>.

<sup>60</sup> Jozias Van Aartsen, *Activity Report: September 2007 – February 2009; Project of European Interest n° NG 3* (Brussels: [European Union], 4 February 2009), <<https://zoek.officielebekendmakingen.nl/blg-12831.pdf>>.

<sup>61</sup> Bartolomej Tomic, “Azerbaijan: Lukoil to Buy Petronas’ Shah Deniz Field Stake for \$2.25B”, *Offshore Engineer*, 7 October 2021, <<https://www.oedigital.com/news/491150-azerbaijan-lukoil-to-buy-petronas-shah-deniz-field-stake-for-2-25b>>.

<sup>62</sup> As part of the SD2 development, the project’s operator BP is implementing expansion of the SCP’s capacity to 22 bcm/y. TANAP is scalable to 23-31 bcm/y by 2023-2026, whilst TAP’s throughput could be doubled to 20 bcm/y with the addition of several compressors.

up more opportunities for Central Asian gas to also join the SGC.”<sup>63</sup> All segments of the SGC will need to operate at full capacity if the project consortia are to be guaranteed a reasonable return on investment and if costs are to be brought down for shippers. Additional, gas volumes sourced from elsewhere than Shah Deniz Two will be necessary to achieve this full capacity.

The Southern Gas Corridor (SGC) is a 3,500-kilometre network of three pipelines: the South Caucasus Pipeline (SCP), Trans-Anatolian Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP). It extends across six countries (Azerbaijan, Georgia, Turkey, Greece, Albania, Italy). According to BP, gas flows under its contract with the Turkish gas company BOTAS for deliveries from the Phase 2 development of Azerbaijan’s offshore Shah Deniz field have “almost reached” the plateau-level of 6 bcm/y. This volume is delivered via the Trans-Anatolian Pipeline (TANAP), which is the SGC’s second leg.<sup>64</sup>

Out of the 10 bcm/y of TAP’s current operational capacity, 1 bcm/y has been contracted by the Public Gas Corporation of Greece (DEPA) and a further 1 bcm/y by Bulgaria’s public gas supplier (Bulgargaz), whilst the remaining 8 bcm/y are destined for Italy and adjacent markets. Concerning supplies to Bulgaria, recurrent delays in implementing the Interconnector Greece-Bulgaria (IGB) have triggered negotiations between Bulgaria Energy Holding (BEH) and the Azerbaijan Gas Supply Company Ltd (AGSC) for shipping of preliminary SGC volumes through the existing Kula-Sidirokastro interconnection point with Greece. In May 2021, it was announced that IGB will not become operational until June 2022. It had last been planned to be ready at the end of 2020—to implement Bulgaria’s 25-year deal with Azerbaijan’s state gas company SOCAR to import 1 bcm/y—after having first been planned to enter into service in 2014, following a 2009 MoU. Nevertheless, the SGC has overall incentivized the implementation of natural-gas infrastructure projects that further enhance the interconnectivity across the broader region of Southeast and Central and Eastern Europe.<sup>65</sup>

According to data from the Trans-Adriatic Pipeline (TAP), daily flows to Italy have been hovering around 24 million cubic metres per day (mcm/d) and even spiking to 27 mcm/d on some days in the third quarter of 2021, i.e., some 10 mcm/day higher than daily contracted volumes.<sup>66</sup> During the fourth quarter of 2020, the TAP, running from Greece to Italy, ensured some 1.2 percent of the total gas imports to the EU from outside the EU. Italy

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<sup>63</sup> Stuart Elliot, “Azerbaijan’s Socar turns attention to Southern Gas Corridor ‘phase two’”, *S&P Global Platts*, 17 February 2021, <<https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/021721-azerbajians-socar-turns-attention-to-southern-gas-corridor-phase-two>>.

<sup>64</sup> For more information see David O’Byrne, “BP confirms gas flow halt under expired Azerbaijan-Turkey contract”, *S&P Global Platts*, 27 April 2021, <<https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/042721-bp-confirms-gas-flow-halt-under-expired-azerbaijan-turkey-contract>>.

<sup>65</sup> For details, see Mariana Liakopoulou, *The Opening of the Southern Gas Corridor*, Energy Security Program Research Brief 2 (Toronto: NATO Association of Canada, January 2021), <<https://natoassociation.ca/the-opening-of-the-southern-gas-corridor/>>.

<sup>66</sup> Baylarbayov, “Azerbaijan’s SOCAR eyes expansion as gas to remain important”.



even managed to send gas to northwestern Europe upon occasion, which is quite remarkable for wintertime.<sup>67</sup>

TAP launched a new market test on 12 July 2021 so that shippers might express interest and later perhaps secure access to new, long-term capacity in the pipeline.<sup>68</sup> However, the pipeline did not succeed in attracting binding bids during the period for their submission, between 17 and 22 July 2021<sup>69</sup> TAP had proposed three expansion scenarios: a limited expansion to 14.4 bcm/y, a partial expansion to 17.1 bcm/y, and a full expansion to 20 bcm/y.<sup>70</sup>

Higher spot gas prices from the start of 2021 made it more economical to consume gas that had been purchased at lower prices in 2020 and injected into storages. European gas fundamentals remained tight over summer 2021, mainly due to uncertainties over supply concerning Russia. These uncertainties included the temporary suspension of deliveries via the Yamal-Europe pipeline, across Belarus and Poland to Germany, as well as via the Nord Stream 1 pipeline, under the Baltic Sea also to Germany;<sup>71</sup> and also Gazprom's decision not to book additional transmission capacity through Ukraine.<sup>72</sup> However, a European market that is short of natural gas, and thus in backwardation,<sup>73</sup> does not answer questions about the long-term import demand perspectives in Europe, especially in view of the planned decarbonization of the internal gas market.

All these considerations underscore the present Research Study's main argument, *viz.*, that the Dostluk settlement constitutes in the first place a geopolitical success for the parties concerned. Although Central Asian gas exports to the EU via the SGC are important for discussions about the EU's diversification of gas suppliers, a condition for such exports remains the commercial viability of investments that, because of their conventional

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<sup>67</sup> Market Observatory for Energy, Directorate-General for Energy, European Commission, *Quarterly Report on European Gas Markets with focus on financing models of hydrogen projects in Europe*, 14:1 (First quarter, 2021) (Brussels: European Commission, 2020), [https://ec.europa.eu/energy/sites/default/files/quarterly\\_report\\_on\\_european\\_gas\\_markets\\_q1\\_2021\\_final.pdf](https://ec.europa.eu/energy/sites/default/files/quarterly_report_on_european_gas_markets_q1_2021_final.pdf).

<sup>68</sup> Trans Adriatic Pipeline, "TAP Launches 2021 Market Test", 12 July 2021, <https://www.tap-ag.com/news/news-stories/tap-launches-2021-market-test>.

<sup>69</sup> Joseph Murphy, "TAP fails to attract binding bids for expansion", *Natural Gas World*, 26 July 2021, <https://www.naturalgasworld.com/tap-fails-to-attract-binding-bids-for-expansion-90646>.

<sup>70</sup> Trans Adriatic Pipeline, "TAP Launches Binding Phase of its Market Test", 17 May 2021, <https://www.tap-ag.com/news/news-stories/tap-launches-binding-phase-of-its-market-test>.

<sup>71</sup> Vladimir Afanasiev, "Gazprom closing key gas export pipelines as Europe prices soar", *Upstream*, 30 June 2021, <https://www.upstreamonline.com/production/gazprom-closing-key-gas-export-pipelines-as-europe-prices-soar/2-1-1032957>.

<sup>72</sup> Aura Sabadus, "Gazprom shuns Ukraine capacity as questions rise over its market strategy", *Independent Commodity Intelligence Services*, 26 May 2021, <https://www.icis.com/explore/resources/news/2021/05/26/10643894/gazprom-shuns-ukraine-capacity-as-questions-rise-over-its-market-strategy>; see also Lawrence Walker, "Gazprom books extra 0.65mcm/day of gas transit capacity", *Montel*, 16 August 2021, <https://www.montelnews.com/news/1245894/gazprom-books-extra-065mcmday-of-gas-transit-capacity>.

<sup>73</sup> Backwardation occurs when spot prices are higher than forward contracts, i.e., contracts which matures at a later stage. The natural gas futures market is often in backwardation as it sees increasing demand in the winter months and shortages in supply.

upstream and midstream nature, have longer lead times. In addition, LNG exporters may treat Europe as their destination of last resort, depending on Asian demand. Such a situation would create seasonal competition for pipeline suppliers. Therefore, the significance of the Dostluk MoU is that it may encourage the relaxation tensions and may promote cooperation amongst key regional actors in the broader Caspian Sea and Central Asian regions more generally.

It follows from the foregoing analysis that Turkmenistan and other Central Asian gas producers may consider it more profitable to deliver their gas exports to regional markets (China, India, Pakistan, Russia). Nevertheless, their export strategy must be focussed on diversification, so as to avoid the dependence on a single market (such as Turkmenistan's on China), and on developing partnership and cooperation with other interested buyers.

## 6 Conclusion

There is general agreement that the hydrocarbon resources of the Caspian Sea littoral states, of which the Dostluk case study analyzed here is one example, have both a real and a further potential significant effect on the international-security landscape in general and the energy-security outlook of certain NATO member countries in particular. As NATO put it in its July 2018 Brussels Summit Declaration:

Energy security plays an important role in our common security. A stable and reliable energy supply, the diversification of routes, suppliers and energy resources, and the interconnectivity of energy networks are of critical importance and increase our resilience against political and economic pressure. While these issues are primarily the responsibility of national authorities, energy developments can have significant political and security implications for Allies and also affect our partners.<sup>74</sup>

In this paper we have focussed on *security of energy demand* on the part of exporting countries, specifically on one of the three identified threats to the energy flows from Azerbaijan and Turkmenistan: *viz.*, political and economic tensions that might prevent resource development. This focus has led us to examine in detail the history of the conflict over the question of ownership the Kepez/Sardar deposit, including the initial deterioration of relations between the two countries and then their improvement. We have also sought to explain each country's difficulties in establishing a firm supply relationship with Europe, particularly in view of the cyclicity of demand. For that purpose, we relied on the distinction amongst four phenomena on which landlocked countries depend for access to transit routes to international markets: transit infrastructure, political relations with neighbours, domestic stability within transit neighbours, and relevant administrative procedures.

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<sup>74</sup> NATO, "Brussels Summit Declaration: Issued by the Heads of State and Government participating in the meeting of the North Atlantic Council in Brussels 11-12 July 2018", Press Release, 11 July 2018 (last updated 30 August 2018), <[https://www.nato.int/cps/en/natohq/official\\_texts\\_156624.htm](https://www.nato.int/cps/en/natohq/official_texts_156624.htm)>.

Framed by such a conceptual approach, we have demonstrated how the signature of the Convention on the Legal Status of the Caspian Sea in 2018 has been conducive to the emergence of tighter co-operation across the Caspian Sea region. The milestone Dostluk MoU, signed in early 2021, is a result of that. The Dostluk MoU was produced not only by the resolution of that multilateral legal matter but also by the resolution of the bilateral political matter. The latter had been set in motion by an earlier MoU on the further development of energy-sector cooperation, signed during President Berdimuhamedov's official visit to Azerbaijan in August 2017. To achieve this political resolution required Azerbaijan and Turkmenistan, as energy exporters seeking to diversify their customer base in the longer term, to compromise for the sake of common benefit. The Dostluk agreement notably offers Turkmenistan the opportunity to mitigate its overdependence on exports to China, which has been driven by important Chinese investments in the country's upstream and midstream sectors.

Finally, we have taken energy security into account from the standpoint of the importing countries, *viz.*, security of energy supply. For that reason, we examined the timing of the Dostluk dispute's resolution in the context of the joint EU-NATO desire for gas supply diversification, including the SGC's extension to the Caspian Sea's eastern shore, endorsed by the EU in principle now for nearly 15 years. Ahead of a crucial winter heating season in 2021-2022, Europe is faced with sharp gas-price increases, a 10-year record low in gas storage levels, and declining indigenous production due to self-imposed restrictions on production from the Groningen gas field. Nevertheless, additional Caspian gas exports are not a short-term prospect, because Dostluk, as well as any other trans-Caspian project such as the TCGP, remains a conventional upstream and midstream project with longer lead times.

The political resolution of the Kepez/Sardar (Dostluk/Dostluq) dispute nevertheless represents a most important geopolitical marker on the road to deeper Caspian Sea-region co-operation. This is so not only on the bilateral Azerbaijan-Turkmenistan level; it also more implicates a broader set of regional players, including non-littoral Turkey as well as littoral Russia. The energy-security narrative of the EU (including its Member-States who are also NATO members) will necessarily continue to entertain the prospect of supply diversification, including from the Caspian Sea littoral states. In the short term, however, the Caspian Sea region will be characterized first of all by its own continuing quest for stability and interconnectivity. Establishing these would lead to increasing the "economic pie", thereby permitting the diminution of intensity of conflict over other non-economic issues. On that basis, a larger-scale outreach to new and established energy consumers in Europe could afterwards follow.