

The Nabucco Pipeline

LUGAR ENERGY REPORT

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IMPORTANCE OF THE NABUCCO PIPELINE

On July 13, 2009, with only a week's notice, Turkey hosted the celebrated signing of an agreement to move forward on the Nabucco natural gas pipeline. It was a major breakthrough that had seemed unlikely just more than a year ago when U.S. Senator Dick Lugar set out to meet with leaders in supplying and consuming countries.

"Although the time between receiving the invitation and the summit was very short, I knew that the Nabucco project is so important that I had to drop everything to help represent the U.S. commitment to this strategic priority," Senator Lugar said.

Turkish Prime Minister Recep Tayyip Erdogan, a strong Nabucco supporter, convened the Nabucco Inter-governmental Agreement Signing Ceremony and Summit in Ankara, Turkey. Leaders of twelve countries and the European Union showed solidarity for development of the Nabucco pipeline by attending.

"The significance of the Nabucco agreement is far greater than the natural gas it will carry. Agreement on Nabucco is a bold demonstration that governments representing diverse peoples and interests can overcome divisions. It required substantial agreement on energy security between European Union nations, Turkey, Georgia, Azerbaijan, and the United States. It is a signal to the rest of the world that partner governments will not



acquiesce to manipulation of energy supplies for political ends. It also has the potential to build new avenues for peaceful cooperation. This prospect was illustrated in the meeting that Ambassador Morningstar and I enjoyed with Iraqi Prime Minister Maliki after the Nabucco signing this week," Senator Lugar said at a Senate Foreign Relations Committee hearing two days after returning from the signing event in Turkey.

"Nabucco will help diversify gas supplies to many European countries. In the process, it will bring more competition and transparency to natural gas markets, and

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IRAQ SUPPORTS NABUCCO



Senator Lugar, a translator and Prime Minister Maliki in Ankara.

Iraqi Prime Minister Nouri al-Maliki told Senator Dick Lugar that Iraq could provide a substantial portion of the natural gas for the Nabucco pipeline. These sales would be critical to Iraq standing on its own.

The prime minister also emphasized that Iraq still needed U.S. support as outlined in the strategic framework agreement between the two countries. Additionally, substantial private investment in oil and gas infrastructure will be required to make necessary

gains in production, leading to more reconstruction of the country and economy. He said that Iraq is still working on its hydrocarbon law, which aims to ensure that "all Iraqi people" benefit from oil and gas revenues.

"His desire to export natural gas via Nabucco raises an opportunity for Iraq to establish stronger cooperation with Turkey and beyond and to raise money for the substantial post-war rehabilitation of his country," Senator Lugar said.

NABUCCO'S IMPORTANCE, CONTINUED

it will reduce the coercive potential of Russia's natural gas dominance."

Senator Lugar noted that when world economies start to recover, energy demand will rebound, causing tight markets and price increases.

"Under such conditions, markets will be highly susceptible to vulnerabilities that can produce severe supply shocks. Three vulnerabilities stand out as areas of concern for energy diplomacy. First, instability and conflict may disrupt energy flows and undermine needed investment. Second, governments may make supply and investment decisions based upon politics, not economics. And finally, terrorist activity may threaten major energy infrastructure.

"In the near term, if we fail to address these vulnerabilities, the prospects

for economic recovery could be seriously imperiled. An oil price shock that hits just as a recovery is beginning and demand for energy is increasing would likely generate inflation, undermine

market confidence, and increase the risks of conflict. Over the longer term, even if we hope for a conversion from a fossil fuel dominated economy to one that depends

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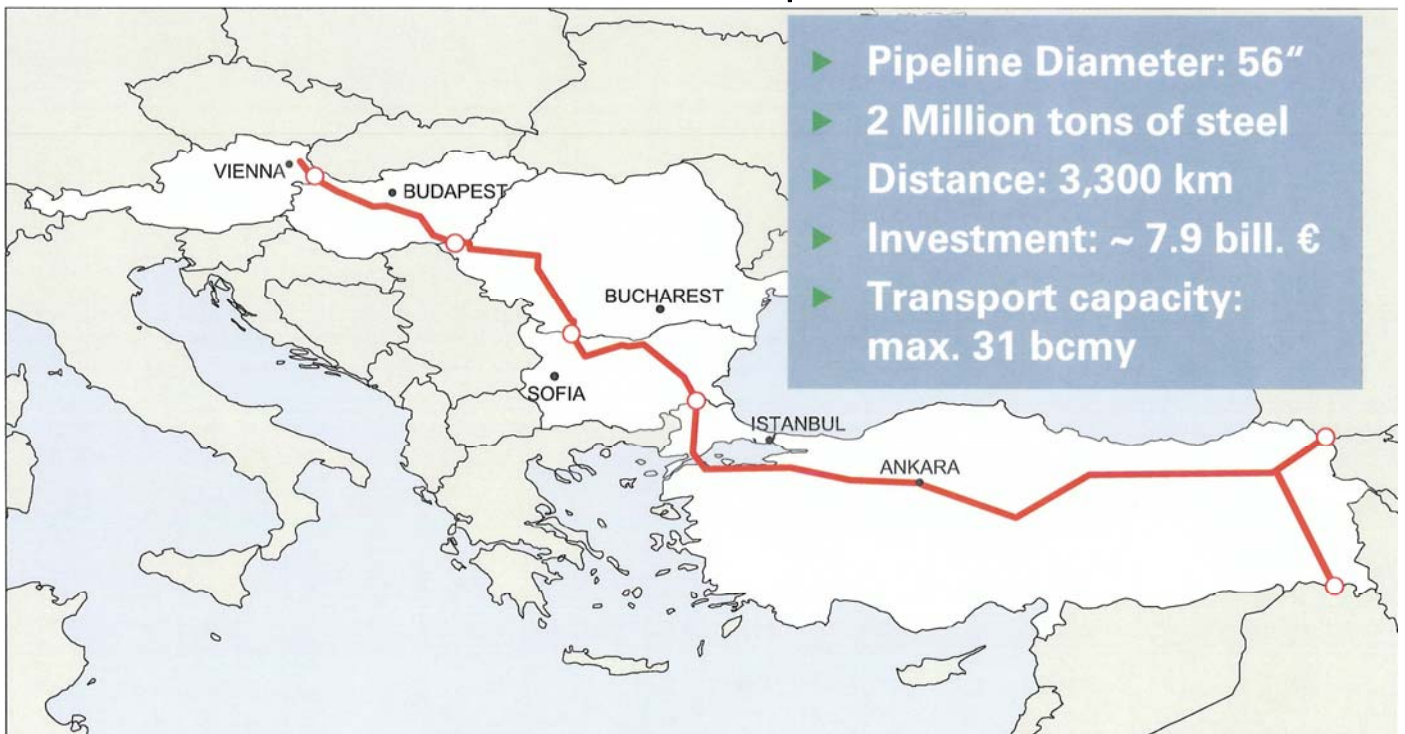


Senator Lugar's mission to Ankara concluded with a lengthy conversation with Turkish President Abdullah Gul, a stalwart Nabucco supporter. The Turkish government projects its own energy needs will rise substantially with economic growth, and Turkey is heavily reliant on Russia for its gas needs. President Gul reaffirmed Turkish pride in being a reliable partner in energy with the U.S. and European partners. Senator Lugar met with the President nearly one year prior at a time when Nabucco threatened to be a distant reality. In welcoming Senator Lugar to the Presidential compound, President Gul thanked him for his Nabucco commitment, stating that the day's summit was "due in large part to your unwavering support."

"Nabucco will help diversify gas supplies to many European countries. In the process, it will bring more competition and transparency to natural gas markets, and it will reduce the coercive potential of Russia's natural gas dominance."

-- Senator Richard Lugar

The Nabucco Pipeline



NABUCCO'S IMPORTANCE, CONTINUED



Senator Lugar and Ambassador Morningstar met with Turkish Energy Minister Taner Yildiz. Minister Yildiz said that signing governments were responsible for the continuing viability of the pipeline.

much more on renewable resources, failure to maintain consistent supplies of oil and natural gas in the interim could be debilitating to our economy and our national security," Senator Lugar continued.

"These are problems that require cooperation with other governments. We can work on long-term U.S. energy independence largely through domestic efforts, but short-term and medium-term energy security is highly dependent on the decisions, investments and political attitudes of other countries. Consequently, there are few topics on which U.S. foreign policy has a greater responsibility to engage."

Russia's dominant position in natural gas delivery to European and Caucasian allies is an important concern for the United States. By interrupting natural gas and oil supplies to several countries, Russia has demonstrated a propensity for politically motivated supply decisions, rather than operating as a reliable market partner. Division within Europe over energy security has been driven in large part by each individual country's relations with Russia, resulting in negative consequences for unity in the trans-Atlantic alliance, stress on NATO, and threats of internal disruption for individual countries.

Azerbaijan, Georgia and Turkey have cemented an extraordinary partnership between their countries and the United States with the flow of Caspian energy through the Baku-Tbilisi-Ceyhan oil and South Caucasus natural gas pipelines. Nabucco will connect with the South Caucasus pipeline in Turkey and extend through Bulgaria, Romania, Hungary, and Austria. Nations adjoining the Nabucco route can all benefit from this new natural gas corridor.

Nabucco offers a valuable opportunity for direct trade between Azerbaijan and,

prospectively in the next few years, Turkmenistan and Kazakhstan. This would be valuable diversification for Central Asian states currently dependent upon Russia for nearly all their energy exports. Additional opportunities for international partnership and increased transparency in global energy markets exist with possible Nabucco connections for gas from Egypt and Iraq, which were both represented in Ankara.

Although the United States is neither a customer nor a producer of the natural gas that will traverse the pipeline, steadfast American support over many years has been instrumental in keeping Nabucco on the agenda and for bolstering the confidence of partner countries.

Diplomatic support for Nabucco has been essential, but Senator Lugar also reinforced the message that it is a commercial project. Gas flowing through Nabucco will be bid competitively and transparently. The Nabucco pipeline will be owned by five companies representing the five transit countries as well as the German energy firm RWE, representatives of which Senator Lugar met with in Ankara. RWE's inclusion in the Nabucco consortium has boosted its financial standing and helped solidify support within the German government for the project.

Lugar's 2008 Energy Missions

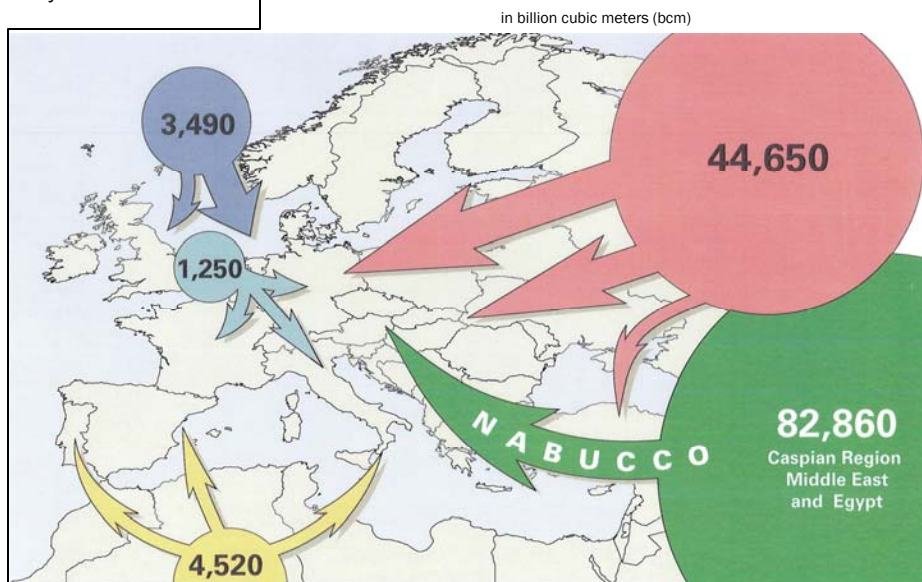
Lugar's attendance at the Nabucco signing summit was his second energy security mission to Turkey in less than a year, and built upon many years of work on energy security in the region.

In 2008, Senator Lugar undertook a three-leg mission to promote energy security that took him from Central Asia, through the southern Caucasus and Europe, and to Russia.

"Access to reliable energy supplies is at the heart of security concerns for many countries, including the United States. As some nations seek to tighten control over increasingly scarce supplies, oil and natural gas has come to be used for political gain and can be used as a weapon,"

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European Natural Gas Supplies



NABUCCO'S IMPORTANCE, CONTINUED

Senator Lugar warned. "The absence of a collaborative energy security strategy will lead to greater fragmentation among European nations and across the Atlantic. This fragmentation will not be exclusive to energy policy; it may also detrimentally impact our ability to act upon shared security and economic issues."

Senator Lugar's Nabucco energy missions have come at a critical time. The trans-Atlantic alliance long has been a source of stability and prosperity in the world. However, unity in the alliance has come under strain as some countries struggled to improve their energy security. At the heart of perceived energy trade insecurity is Russia's hitherto monopolistic control over oil and natural gas exports from the Caspian Sea region and its domination of natural gas flows to much of Europe. Russia's energy sector is dominated by government officials in the Kremlin, and in recent years the government has demonstrated a willingness to use Russia's status as an oil and gas powerhouse to influence – and even threaten – its neighbors. In fact, at least six European nations have experienced politically-charged energy cut-offs in the previous two years.



Senator Lugar with Hungarian Prime Minister Bajnai Gordon. Prime Minister Bajnai said part of the reason the Nabucco project had finally moved forward was because natural gas outages in supply lines from Russia affected 150 million people. He noted, however, that the EU still does not have a coordinated energy policy.

proliferation of nuclear weapons materials.

Senator Lugar granted that Russia will be Europe's preeminent energy supplier for decades, but commented that it does not have to be a confrontational relationship. Reducing Russian government political sway over energy trade is an important component of building relations with that country.

Meanwhile, U.S. and European strategic, trade, economic, and public diplomacy interests intersect in Central Asia. With Russia to the north and Iran and Afghanistan to the south, energy-rich Central Asia should be at the frontline of American and European national security priorities. Senator Lugar's mission to the Central Asian countries of Kazakhstan and Turkmenistan reinforced his belief that it will take time and a consistent high-level diplomatic effort to build constructive relationships.

In Kazakhstan, the U.S. has a record of 15 years of collaboration on nonproliferation and weapons destruction through the Nunn-Lugar program. This is a solid foundation on which to continue building our relationship. Turkmenistan was an extremely isolated country after the dissolution of the Soviet Union, but the country has undergone extraordinary changes since President Gurbanguli Berdimukhamedov came into office in 2007. Understanding the potential for improved relations with Turkmenistan will require thoughtful diplomatic attention to the country; Senator Lugar was among the first senior U.S. officials to visit Turkmenistani officials in the capital city, Ashgabat.

Kazakhstan and Turkmenistan rely almost exclusively upon Russia to transport their oil and natural gas to world markets. Already, Russia dominates exports from the region and is strongly pushing to lock-up transit rights for new oil and gas supplies. Opening trans-Caspian export routes will dilute Russia's control over energy supplies. Likewise, having multiple export options will reinforce the political independence of Kazakhstan and Turkmenistan. In meetings with Senator Lugar, Kazakh and Turkmenistani officials indicated a willingness to work with its neighbors and the United States on trans-Caspian oil and gas transport. Recent explosions and

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Senator Lugar with Georgian President Mikheil Saakashvili in Ankara. Georgia is an important transit country for oil and gas.

Senator Lugar's meetings promoted unity of purpose in forging a cooperative trans-Atlantic energy security strategy. He vigorously advocated a first priority: completing the so-called East-West energy corridor to bring oil and natural gas across the Caspian from Central Asia to distribution points in Europe. This led to meetings with top government officials in: Kazakhstan, Turkmenistan, Azerbaijan, Georgia, Turkey, Romania, Ukraine, Germany, France, and the European Union based in Belgium. Adding the Nabucco natural gas pipeline to the East-West energy corridor will be a bulwark against political manipulation of gas energy supplies in the region by helping to provide diversification of gas supplies to Europe.

In December 2008, Senator Lugar went to Moscow to discuss with Russian officials the possibilities of getting the strategic arms talks restarted. He noted that even in times of tension between the two nations, cooperation can and should continue on critical issues of mutual interest – in particular combating

NABUCCO'S IMPORTANCE, CONTINUED



Senator Lugar and Ambassador Morningstar meet with the media at the Ankara summit.

continuing closure of the Turkmen pipeline to Russia has heightened interest in an alternative route to market.

Azerbaijan, Georgia and Turkey have made exceptional progress on improving cooperation from the Caspian Sea to the Mediterranean Sea. The hallmark achievements of that cooperation are the Baku-Tbilisi-Ceyhan oil pipeline and parallel South Caucasus natural gas pipeline. Those two pipelines already cross Azerbaijan, Georgia and Turkey to deliver energy to global markets. Senator Lugar encouraged expansion of the current pipelines to integrate oil and natural gas production in Kazakhstan and Turkmenistan for export across the Caspian Sea. Successful integration of such trans-Caspian transport routes was described by Senator Lugar as a "vital contribution" to international peace and security.

Once dependent solely on Russia for natural gas needs, energy cooperation has enabled Azerbaijan and Georgia to attain a much greater degree of diversification in energy, thus bolstering their economies and independence. Yet these countries exist in a tough neighborhood and are under tremendous pressure to keep their distance from the United States. In meetings with Azerbaijan's President Ilham Aliyev, Senator Lugar reinforced the promise of the growing strategic partnership with the United States. Senator Lugar also encouraged continued progress on transparency for oil and gas revenue management in Azerbaijan.

The difficulty in building diplomatic relationships in the region was tragically highlighted in conflict between Russia and Georgia during the summer of 2008. Senator Lugar visited the emerging democracy and U.S. ally Georgia shortly after the cessation of conflict with Russia. He met with victims of violence, bolstered the morale of U.S. troops and aid workers providing vital services and visited with Georgian government officials. His visit highlighted the need for the U.S. and Europe to improve dialogue in the region and with Russia because, in his words, "we are all going to be in the area for a long time."

By diversifying its sources of energy, Turkey

stands better positioned to attain the energy necessary to meet its economic expectations and further enhance its critical security partnership in the trans-Atlantic Alliance.

Senator Lugar's energy security mission in 2008 also took him to several European countries critical to the success of the Nabucco pipeline project, as well as forging a cooperative strategy for energy in Europe and with the United States. He emphasized the need for Europe to strongly commit to construction of the Nabucco pipeline. Without such commitment, Russian-backed alternative pipelines might undermine Nabucco and further entrench European dependence on Russia for natural gas.

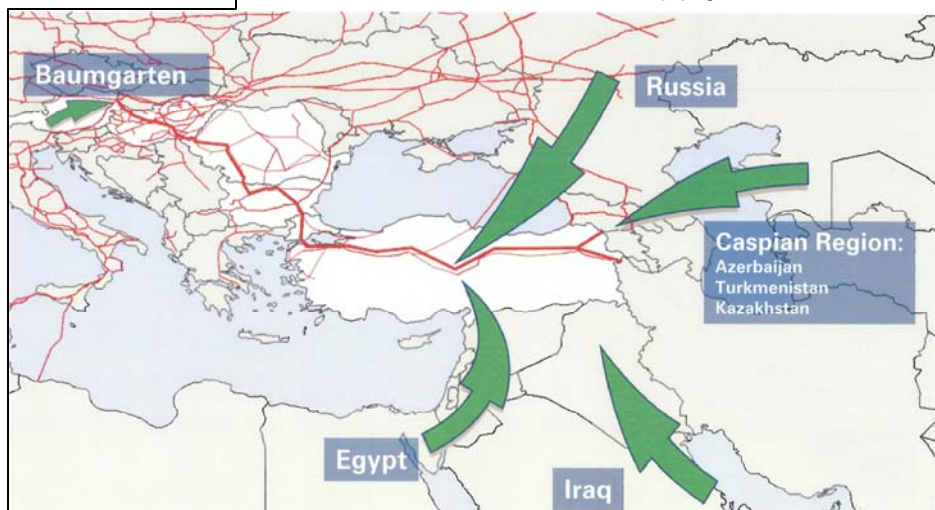
Numerous NATO and European Union member states have attempted to make the Nabucco pipeline a reality. In Romania, Senator Lugar encouraged ongoing support for the Nabucco project and praised the President of Romania for his personal diplomatic activity. One of the few countries in the region with domestic oil and natural gas production, Romania currently imports about a quarter of its gas from Russia. As with its neighbors, Romania's long-term security requires diversification of energy resources.

In Ukraine, Senator Lugar continued his ongoing discussions with the country's leaders about the need to diversify their energy resources and the domestic political cooperation necessary to reach that goal. In the middle of winter in 2006, Ukrainian gas supplies were cut off by Russia, leading to further disruptions in service to other European countries. Since that time, Ukrainian and Russian natural gas pricing disputes have continued. Meanwhile, difficulty in maintaining government unity has presented problems for Ukraine in making needed progress. Senator Lugar reaffirmed his support for Ukraine's democratic emergence and encouraged deeper partnership with the United States.

As an economic and political leader in Europe and worldwide, Germany plays a central role in the trajectory of energy security. Germany is already a global leader in renewable energy technologies, yet its support for the Nord Stream pipeline that would connect Germany directly with Russia is seen by some European nations to be counter to long-

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Potential Nabucco Supply Sources



NABUCCO'S IMPORTANCE, CONTINUED

term energy security for Europe. Meeting with government officials and industry leaders in Berlin, Senator Lugar emphasized the need for German leadership on Nabucco and other necessary energy market reforms in Europe.

Senator Lugar also carried his message to the headquarters of the European Union in Brussels, Belgium, where he was joined by former U.S. Special Envoy for Eurasian Energy C. Boyden Gray. The European Union faces a strong challenge in finding unity in energy security strategy while some of its member states seek to protect their domestic energy champions and prefer to strike bilateral deals with Russia. Senator Lugar emphasized the need for the EU, along with the United States, to build diplomatic relationships in Central Asia and to give strong political support for Nabucco. Senator Lugar also discussed other steps, such as renewable energy and use of productive agriculture for food and energy purposes, to help improve trans-Atlantic energy security.

Conclusion

Purposeful and cooperative efforts today can help rebalance leverage over energy supplies and prevent confrontation. While little oil and natural gas from Central Asia will reach American consumers directly, the supplies are critical to the energy security of our European allies and to international markets.

By promoting more productive relationships between leaders in Central Asia, the south Caucasus and Europe, Senator Lugar continued his ongoing efforts to reduce the political and economic risks of current global energy trends, and reduce the potential for conflict over scarce resources.

A major discussion at the Ankara meeting was the hopeful possibility that Iraqi natural gas would also flow into Nabucco, helping Iraq to stand on its own and enhancing the prospects for stability and commerce in the region.

The United States uses more energy than any other country. Recent gains in American energy efficiency and new renewable energy sources are being more than offset by surging demand in emerging economies, particularly China and India. At the same time, without radical changes in the way we generate and use energy, oil and natural gas rich countries' influence will increase in political, economic and in some cases military spheres. The regrettable reality is that some of these countries will use their newfound influence against U.S. and EU strategic interests. Moving forward on the Nabucco natural gas pipeline is a major strategic step to blunt these threats.

SENATOR LUGAR'S NABUCCO STATEMENT

The following is Senator Lugar's statement as delivered at the Nabucco Inter-governmental Signing Summit in Ankara. He was introduced by Ambassador Richard Morningstar, U.S. Special Envoy for Eurasian Energy.

Building strong partnerships on energy security in this region has been a priority for the United States government. It is a testament to the strength of the U.S. commitment to energy security in this region that Secretary of State Clinton, with bipartisan support in Congress, has appointed an experienced diplomat to be a full-time representative on this issue.

As we stand together today, we mark an event that will undergird a more prosperous, secure, and peaceful future for us all. One year ago, I traversed the proposed Nabucco pipeline route on a mission to encourage progress and cooperation. Many people doubted whether the political agreement that is being signed today could ever be achieved. The journey to this point has taken courage and visionary statesmanship by numerous leaders. I thank all who have labored to advance the Nabucco agreement. In particular, I congratulate our hosts, President Gul and Prime Minister Erdogan, for their leadership.

Nabucco will provide diversification of natural gas that will benefit supply, transit, and consumer countries alike. It is vital that all of

us commit to ensuring that the Intergovernmental Agreement is implemented fully.

Energy security is at the heart of every nation's national security and economic concerns. Yet sometimes a country's pursuit of its own energy security leads them to policies that can damage their allies and neighbors. The consequences of energy insecurity for any one country represented here today could have severe consequences for all the rest: conflicts may erupt; alliances may be strained; and achieving common interests such as non-proliferation, Middle East peace and economic development may be imperiled.

As we move forward together on energy, each of us must act to find unity wherever possible. We must cooperate, even when the issues are difficult. We must build relationships with independent states in

the Caspian Sea region. We must explore how to improve confidence with Russia on energy. Europe must do more to interconnect its energy infrastructure. The NATO alliance must make energy security a much higher priority. And each nation must explore alternative sources of energy and ways to improve the energy efficiency of its economy.

The significance of the Nabucco agreement we are celebrating today is far greater than the natural gas it will carry. Agreement on Nabucco is a bold demonstration that governments representing diverse peoples and geographies can overcome division. It is a signal to the rest of the world that partner governments will not acquiesce to manipulation of energy supplies for political ends. Today, the European Union demonstrates unity of purpose on energy security and stands strongly with Turkey, Georgia and Azerbaijan. The United States is proud to stand with you.

Too often in history competition for energy supplies has factored in wars and conflicts. Your presence today demonstrates that energy cooperation can be a powerful force for peace.

Seven Heads of Government celebrated the Nabucco treaty signing: Prime Minister Recep Tayyip Erdogan of Turkey, President Mikheil Saakashvili of Georgia, Chancellor Werner Faymann of Austria, Prime Minister Sergei Stanishev of Bulgaria, Prime Minister Bajnai Gordon of Hungary, Prime Minister Emil Boc of Romania, & Prime Minister Nouri al-Maliki of Iraq. Other high-level participants included EU Commission President Jose Manuel Barroso and representatives of Azerbaijan, Egypt, Syria, Germany, & Sweden.