

The Keys to a European Energy Community



The European Union is building an Energy Community to cope with the threefold challenge of climate change, security of supply and competitiveness. This is a praiseworthy objective but we must all seek ways to solve the problems. Given the violent conflicts of interest and prejudices, it is a project as full of risks as it is of hopes. It is one of the priorities of the French presidency of the European Union in 2008. It is therefore a matter of some urgency for France to clarify its strategy and help to shed light on the points under discussion. Philippe Herzog, President of *Confrontations Europe*, presents a number of proposals* in favour of a common energy policy within the framework of sustainable development.

* They are largely based on the discussions that have taken place over the past few years within *Confrontations Europe's* Energy Group chaired by André Ferron and Claude Fischer, which involves numerous French and European players from the energy sector. Log onto: www.confrontations.org.

Two major problems are dividing the Europeans – the choice of energy sources and the regulation of markets.

The Commission and the Council have retained three target objectives for 2020 i.e. a 20% reduction in CO₂ emissions, a 20% improvement in energy efficiency and 20% renewable energies. These three aims are far from easy to achieve. The 20% renewable energies provide only complementary sources of power, leaving the problems of competitiveness and security of supply wide open given that the EU depends on fossil fuels for 80% of its power and that this figure is neither decreasing nor sustainable. Moreover, the three target objectives are subject to different sets of regulations and their interpretation by individual Member States is bound to reveal the profound differences in energy systems.

It is true that Member States retain the right to choose their own sources but their choices must be complementary so that the Union can aim at a coherent energy mix in line with its objectives. The fight against climate change, for example, requires non-carbon or low-carbon sources to have pride of place in the mix and this obviously raises the

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question of nuclear power. The Member States, however, are opposed to this despite the fact that it is the only source, apart from hydraulic power, that meets the threefold challenge (climate-security of supply-competitiveness). This actually explains why nuclear power is the subject of renewed interest worldwide.

The problem of increasing electricity prices should also be highlighted. How could individual and industrial consumers accept the creation of a single market and an Energy Community if the price rises continued and there were major price fluctuations? In the electricity market built up by France, the Benelux countries and Germany, prices are based on the cost of a kWh charged by Germany, which is constantly being asked to provide power – but the German price is the most expensive of all. The Commission is requesting an increase in French prices as an incentive to bring other competitors into our market, thereby refuting the argument that

competition is beneficial. And it seems to ignore the fact that foreign competitors prefer access to our nuclear plants. How could we explain to our citizens, who have chosen nuclear power or who benefit from major hydraulic resources, that they will have to pay a high price for electricity produced using gas and coal when they thought they were moving away from these sources?

Contrary to what is generally thought, it is not merely competition that dictates prices; it is first and foremost the choice of technology. Setting up a single market should encourage the spread of safe, competitive technologies. The end of free CO₂ emissions and the end of cheap gas have led to nuclear power becoming the most competitive source. However, although all countries are ready to accept pollutant, expensive fossil fuels, Germany and a number of other European countries do not want nuclear power. Or, to be more precise, they are happy to import the nuclear energy that other countries have produced but do not want European legislation and regulations to encourage its use. Of course, there is no question of imposing nuclear energy on those who do not want it but divergent national choices of energy sources should not be allowed to introduce inefficiency or even the explosion of the single market.

France can no longer consider nuclear power as a purely national issue. It must ask the Union to establish a strong framework to cover the safety and management of waste. A number of States have opposed this stance. Discussions are continuing in groups of experts. We have to return to the political level to create the conditions for social acceptability of nuclear power. We must also end the divergences in national support systems for renewable energies because this is contrary to the notion of a single, efficient market. Finally, we must make use of the solidarity requirement to support research and innovation with a view to making all sources of energy safe, clean and competitive while achieving energy efficiency.

Discussions on nuclear power, a taboo subject until now, must take place in the Council.

The Commission has become aware of the problem but is not taking action. The other main divisive problem is market regulation. The specific features of the electricity and gas industries have been emphasised time and again. On the one hand, they are network industries and should be treated as public assets, accessible to all at affordable prices.

On the other hand, production is highly concentrated and markets in their infancy are, of necessity, oligopolistic. The competitiveness policy is not sufficient; strong, stable regulations are essential. Yet at the present time, companies face an increasingly complex juxtaposition of several regulations – on a Community level as regards CO₂ emissions, from many different sources as regards energy efficiency, and on a national level as regards new renewable energies. Given these conditions, the markets remain fragmented and price signals are inefficient. The EU has no stable, long-term framework to encourage renewed investment in networks and production capacities.

The Commission is placing its hopes on its own, mandatory choice of structure, based on its exclusive competence for competition issues. This structure would mean separating transport from production and marketing (“*unbundling*”). It now wants to go further than legal separation and impose ownership unbundling. Debate is essential, on both the electricity and gas sectors.

As regards electricity, the Commission is aiming at a single pan-European grid, without congestion and accessible at the same price right across its coverage area. The system has been called a “*copper plate*”. This is far from the case at the moment – numerous hubs are saturated or missing and groups prefer to seek growth on site rather than in every Member State. According to the Commission, ownership unbundling, which would make network operators totally independent, would enable them to invest in hubs. This position totally ignores the hostility expressed by populations and several States to investments in cross-border hubs. And when financial investors are questioned, they say that the establishment of a Community regulation framework is much more important than ownership unbundling. They will be able to fund grids and production capacities just as well if the groups remain integrated rather than segmenting businesses. If the EU wants a *copper plate*, it must have a mandate and regulate the grids as public utilities. This would require supranational competence. Moreover, unifying dispatching (a task that has not yet reached completion) is not sufficient; there must also be reserves to ensure that electricity can be supplied at peak times at a normal price. This means that the Union must create an investment incentive or obligation.

The setting up of stable, competitive wholesale

prices that would encourage energy savings and integrate the cost of CO₂ emissions is especially difficult. How should costs be divided between production and transport? The grids for Danish wind farms are expensive – who should pay? The operators of competitive technologies? Jutland or Denmark alone, or the Community through its structural funds? The real time management of adjustments requires a centralised grid operator but residential and industrial demand may prefer contractual markets or a market segmented on the basis of types of energy. What is the best solution? We also know that the operation of the CO₂ emissions market will have to be extensively improved and take account of the new, global situation. The USA, China and other emerging countries will have to join a global system to fight climate change.

A fundamental difference in gas compared to electricity lies in the fact that supplies come mainly from outside

the European Union.

Safety

imperatives are a priority and there cannot be competition if, as in Poland or all the Baltic countries (despite their best endeavours), all the gas is Russian. Poland was right to introduce a principle of solidarity in the Reform Treaty. Internal regulation of the gas market is impossible without an external energy policy and internal solidarity.

Acting in a dogmatic fashion, the DG Competition within the European Commission wants to base regulation of the gas industry on regulation of the electricity sector. Yet the architecture of the European grid should be designed to allow for competition among external suppliers rather than risking increased dependency on Russian gas or operators. The grid model cannot be a “*gas lake*” ▶▶

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Confrontations Europe and MEDEF are hosting a conference and debate entitled “**Playing the energy policy game in Europe**” on 16th October. The association is preparing a European conference under the title, “**The renaissance of nuclear power, an issue for the European Community**” which will take place in February 2008 in Paris. The conference is being organized jointly by the C.E.R.E.S and *Les Entretiens européens*, in cooperation with the United Kingdom Embassy in Paris and under the sponsorship of the European Commission. For practical information, please log onto: www.confrontations.org and www.entretiens-europeens.org

▶▶▶ supplying the entire Union. It presupposes one master plan giving priority to the hubs and storage required to ensure solidarity between Member States and another for the hubs forming the basis of competition. A grid for the Community as a whole should be jointly financed by all operators and regulations should be established to cover payment for grid access. On the other hand, investment outside this grid would be left to the operators and States.

Whatever the degree of separation between the grids, they will remain natural monopolies. Investments based on European guidelines will depend on regulation and not separation. Given this situation, ownership unbundling i.e. the obligation for integrated gas operators to sell their networks, is

fraught with dangers.

It is a gigantic unbundling operation

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for which the Commission's impact studies have totally failed to assess the economic and financial effects. They would vary widely from one country to another and one operator to another. Let us not forget that, historically, there have been two types of operators, one group specializing in oil and gas exploration and production (e.g. British Petroleum) for which transport is only of marginal interest and the other group specialising in transport and supply (e.g. Gas de France) which is trying to move towards production in order to achieve growth. Total separation would make the second group more fragile while having hardly any effect at all on the first. This could be considered as structural discrimination and raise major political issues. The development of competition in the gas sector depends on external factors. Producers must fund investments in other countries. Total separation would deprive integrated operators from the financial basis required to invest in production. Moreover, the Commission's current reticence with

regard to long-term supply contracts poses a major problem. In actual fact, a "second generation" legal separation, which is being proposed by leading industrial consumers and energy experts, would be sufficient to make standardisation and the regulation of grid access easier.

The Commission which, for many years, has been negligent with regard to the risks of takeovers of European corporate grids and capacities by foreign Groups, risks which would be multiplied by ownership unbundling, has recently accepted a principle of reciprocity. Under its terms, there could be no takeover of interior grids by foreign Groups if they themselves are not unbundled. However, this restriction is incomplete and may be a sham. Incomplete: it must be extended to production capacities and liquefied gas. A sham: several companies and Member States are, or will be, willing to welcome *sovereign funds* or even foreign Groups. Division is certain. Russia will no more consider adopting European rules than the EU is willing to adopt Russian rules yet a mutually-acceptable compromise must be found with regard to industrial choices because our destinies are linked. The setting up of European markets is only justifiable if there is a long-term Energy Community objective taking on an industrial policy for sustainable development and playing a role as a global driving force to save the planet from climatic disaster and an energy famine. The competition policy is neither an end in itself nor a miraculous means to an end. If Community choices are to be understood, accepted and well-founded, a fundamental issue of democracy must be raised. The Commission must be reorganised so that it is responsible for industry, public assets and competition. Institutional conditions have to be laid down to create a unit that is essential if we are to lead an external energy policy. European regulators must be appointed. Cooperation with the European Parliament and national Parliaments is imperative and they must set up discussions with civil societies.

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