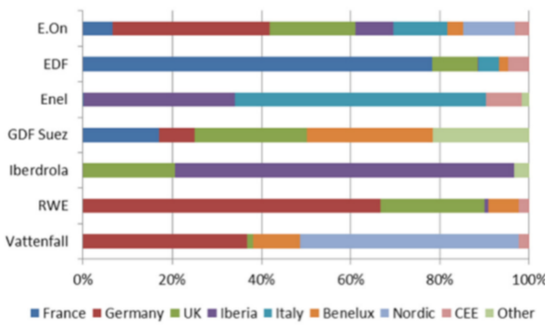
Perry Sioshansi's Letter from America

Facing similar woes, Europe's Big Seven follow similar script

Europe's major utilities are preparing for new order.

It is not easy being an incumbent utility in Europe, or for that matter, in many other parts of the world. The rapid proliferation of renewables generation, often subsidised and/or mandated, is making thermal generators unprofitable. Simultaneously, rising retail tariffs encourages energy efficiency investments and/or self-generation.

Installed generation capacity of major power utilities in Europe



Source: Clingendael Energy, 2013

RWE, Germany's second biggest utility, is repositioning itself to confront the challenging times ahead. E.ON, Germany's biggest utility appears to be thinking along the same lines. In fact, the same can be said about Europe's seven biggest utilities who collectively account for the lion's share of EU's current installed capacity and generation (*graph left*).

A report published by Clingendael Energy (*European Power Utilities Under Pressure?*) points out that the power majors have to revise their strategies by focusing on cost reduction on the one hand while investing in activities outside of the EU power sector, as well as investments in new businesses within the EU on the other, whether in renewables or energy services.

In an interview with *Energy Post* published 5 December, E.ON's chief executive Johannes Teyssen, acknowledged a rather dismal picture with little or no growth in its domestic market, and increased pressure to develop businesses outside its core markets while facing the challenge of differentiating itself from its main EU rivals—all following a similar script. He said governments should stop subsidising renewables altogether—echoing a sentiment publicised by the so-called Magritte Group.

Teyssen is against new EU-wide renewable energy targets for 2030, ditto for any new energy efficiency targets. He told *Energy Post* that renewables "have all the chance in the world to take the biggest chunk of the market" even without subsidies—hence his call for an end to renewable subsidies. Teyssen's dislike of renewables is shared by the CEOs of all major European utilities. Nor does he favour any pan-European climate policy initiatives believing that the current carbon market, i.e. the EU Emission Trading Scheme (EU ETS), is adequate as is. Despite the EU ETS's low and volatile prices, which thus far have not resulted in any long-term investments in low-carbon technologies, Teyssen says the scheme is "perfectly compatible with economic growth and jobs."

Regarding E.ON's own business strategy, Teyssen acknowledges that "the upstream, commodity side" of the European electricity market "is shrinking at high speed", so "we are trying to replace it with the distribution, retail side". He said E.ON will engage in "a smarter renewables development" by being "just the driver and innovator."

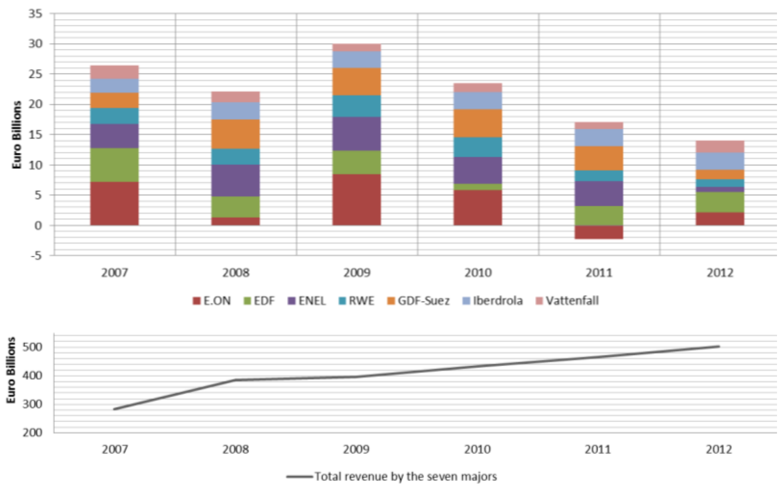
The message sounds nearly identical to RWE's new business strategy: a new customer-centric focus, moving from "volume to value," and becoming an enabler in an environment of increasing decentralised and intermittent renewables generation—as outlined by Peter Terium, RWE's chief executive. "I think everyone understands at this point that value creation is moving downstream, to the customer, from the commodity side to the solution side. So E.ON is striving hard in Europe to go to those parts of the value chain where we are close to our 25mn customers, where we enable them and can share with them the advantages of efficiency", Teyssen said.

On the topic of a stagnant and saturated European market, he said E.ON will look at international opportunities "because we believe that Europe will see low growth and in a more downstream, customer-based environment our market share will almost necessarily shrink". He mentioned new ventures already established in Turkey, Russia and Brazil. "It's not that we are trying to leave Europe; Europe will still be by far the biggest base in our businesses but by definition its value size and its market share size will shrink and thus if we want to try to defend a meaningful size we need to try to be somewhat more international."

With no growth prospects, the prevailing view is that the EU market is a zero-sum-game where one company's gains will come at the expense of someone else's losses—against the background of growing renewables and distributed generation. Describing E.ON's strategy, Teyssen said: "I would probably say at this point it's (E.ON's business strategy) about first stabilising it before you dream of growing it. Because the upstream, commodity side is shrinking at high speed, we are trying to replace it with the distribution, retail side but even there we are still talking about finding a stable base. Overall the EU part will shrink, not grow." That, coming from Europe's second biggest utility, and current President of Eurelectric, makes it noteworthy.

When asked about how E.ON intends to differentiate itself from the other incumbents, all of whom are facing nearly identical woes, he said: "There are bits and pieces [of E.ON's strategy] that sound similar to those of others, no doubt about it. All the companies see the value in the more stable parts of the value chain, closer to their customers, finding a new connection there, building trust. It's a question of what precisely are you prioritising? The differentiator will be: can you outperform others in your technology access and your customer access?"

Net income and total revenue of the seven major EU power utilities



Source: Clingendael Energy, 2013

Reading between the lines, the message that comes from the Big Seven—to varying degrees—may be summarised as:

- continue to lobby their national governments as well as the European Commission heavily to change the rules in their favour—specifically in removing or reducing renewables subsidies and introducing capacity payments;
- hang on to profitable generation assets, which will be needed—despite the glut of capacity—for back-up while pushing for capacity payments;
- maximise value from T&D assets, while pushing for higher transmission and network connection fees;
- expand profitable trading and risk management services to retailers and customers;
- explore other lucrative markets outside the EU, while being mindful of inherent risks in such opportunities;
- become "enablers" in a decentralised future;
- hang on to their customer base as best as they can; and
- invest selectively in areas where smaller players cannot afford and/or lack the necessary know-how.

Both RWE and E.ON appear to be following this script. The others, while deviating from the plot, are likely to pursue many of the same strategies.

Perry Sioshansi is a specialist in electricity sector restructuring, and he has been actively involved in discussions in a number of developed, developing and transition economies. He is founder and president of Menlo Energy Economics and is the editor and publisher of EEnergy Informer, from which we have sourced this article, and which we commend.

Nutwood contains occasional pieces from guest contributors on key industry and policy issues. If you have a point of view that you would like to see featured, please contact our editor Andrew Mower. His contact details are 01603 604403 or andrew@cornwallenergy.com.