The Single Market Challenge
Who takes charge of the missing links?

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The European Single Market offers solutions to meet the security of supply, sustainability and competitiveness targets

1. Integrated renewable generation capacity in Northern and Southern Europe.
2. Improved supply reliability through increased flexibility to reduce blackouts and the need for back-up services for renewable energy sources (RES).
3. Increased cross-border competition.
4. Contribution to setting the right incentives for investments.
5. Contribution to internal solidarity reducing the isolation of less-favored and island regions.
6. Improved position for international CO₂ target negotiations.

To realize these targets, there is in place an ambitious roadmap towards a low-carbon economy with three key milestones at 2014, 2020 and 2050

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- Seven regional clusters to facilitate market coupling
- “Third Energy Package” as a key regulatory tool

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However, so far, limited advances towards European integration have been seen in the market place, mainly due to a lack of cross-border infrastructure development.

Interconnection capacity concentrated in Central Europe

Low growth in energy exchanges between countries

Limited development of cross-border infrastructures

Source: ENTSO-E and Accenture Analysis

Generation capacity additions are in the right direction, but investment cuts can put the medium-term security of supply and 20/20/20 targets compliance at risk

Successful delivery of net generation capacity additions, but future is still challenging requiring a bigger effort

System adequacy has been maintained due to capacity additions and weak demand

But capital expenditure has begun to contract due to economic downturn, with impacts in the medium term

And aging conventional plant shutdowns are starting to accelerate, adding more pressure

Investments appear to be a key challenge. Even core cross-border infrastructures to support EU targets require triple the current transmission system operator (TSO) investment levels.

**2011 to 2035 total investments ~ €2,000 Bn**
- T&D: 8% (€160 M)
- RES: 10% (€192 M)
- Nuclear: 52% (€1,045 M)
- Fossil: 30% (€600 M)

**European priority investments to 2020 ~ €140 Bn**
- Market Delivery: 50% (€70 Bn)
- Financing Gap: 50% (€70 Bn)

Priority annual TSO investments 2010 - 2020

Avg. annual TSO investments 2005 - 2009

*Only for projects of European interest to meet EU 2020 targets*

**Summarizing...**

**Market model definition**
- The EU has defined an ambitious agenda to meet the challenges of a low-carbon economy with specific goals and deadlines.
- Target models and approaches are established, with European regulation progressing adequately.

**Implementation**
- In general terms, implementation is constrained at the national level, with delays in the Third Energy Package adoption and cross-border developments (<0.5% annual growth during the past 10 years).
- Different integration speeds are detected across Europe with more advances in Central Western Europe and Nordic countries.
- Generation targets are also at risk due to investment cuts, with potential issues for security of supply in the medium term.
- There is an urgent need to accelerate infrastructure work given the proximity of the target dates (2014 and 2020). Investments and their financing appear to be the main challenge.
Who takes charge of the missing links?

The European Single Market and the investments challenge.

Are there missing links or has the world changed?

What are the recommendations to mobilize the required investments and meet our commitments?

The economic downturn and limited incentives present utilities with a number of issues when facing their investment challenges

- European utilities sector underperforming by comparison
- Value destruction despite WACC reduction
- Modest own cash flow to finance capital expenditure
- Growing leverage and high debt premium

Source: Accenture Analysis

Source: Eurelectric

Source: Company Annual Reports and Eurelectric
There is also growing global competition for available capital, leading to less European emphasis.

Reduced regulated returns to attract investments.

And political interventions are generating a complex environment for investments, increasing the level of uncertainty and reducing expected returns.

Challenging RES support with countries like Spain reviewing its legal framework.

New burdens to the sector to tackle government lack of funds and consumer affordability issues.

Tax increase
- Nuclear tax in Germany, Spain and Finland
- “Robin Hood” tax in Italy
- Corporate tax increase in Portugal
- Tariff increase below inflation in France
- ...
Natural gas generation technologies now appear more interesting investment options compared to nuclear and RES – even though there are dependent on political intervention.

Maximum historic differences with US gas price due to shale gas and European oil linkage

Short lead time for CCGT construction and low need of initial capital

CO₂ price collapse from 2008 peak

Contracted electricity price due to weak demand, putting at risk peaking plants profitability

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In the current market environment, traditional sources of finance in the power industry have limited capacity to mobilize the required capital.

Risk of a second recession for EU27

GDP Growth
- 2011: 1.5%
- F2012: 0.0%

Source: European Commission

High national debt levels and government imposed deficit control measures

Unemployment rate is increasing and not stable

Higher electricity prices are impacting industrial competitiveness

In the current market environment, traditional sources of finance in the power industry have limited capacity to mobilize the required capital.

Financing new investments will require shared efforts, innovative solutions and, most likely, an adjustment of current policies.

Three basic Ideas: 1) An “attractive” product, 2) New buyers and 3) Maximizing the impact of current capabilities

Assure competitiveness of EU investments
- Provide competitive profitability with a global perspective.
- Facilitate overcoming any issues around the construction and pre-construction phases.
- Consider economic mechanisms to encourage integrated infrastructure investment and back-up generation construction.

Find new equity sources
- Attract new investment agents such as institutional investors and foreign utilities companies.
- Capitalize on the underlying equity of mature projects to fund new projects.

Leverage limited public funds
- Limit the use of direct subsidies to unlock critical projects.
- Collaborate with financial institutions to provide preferred lending conditions.
- Support “green bond” emissions through EU guarantees.
- Promote role of EU and governments as direct investors to start critical projects.
Reducing uncertainty and recovering confidence in government policies are both key to regaining predictability

- The EU view and guidelines on **nuclear power and shale gas**.
- The **role of the consumer in financing** the single market and the low-carbon economy taking into account affordability and competitiveness issues (e.g., through significant **tariff increases**).

- **Clarify position on controversial issues**

- **Increase EU coordination**
  - Coordinated approach for **RES support**, to promote generation deployment **according to geo-climatic conditions**.
  - Improve global view for **multi-state transmission and distribution project** identification.

- **Regulatory harmonization and stability**
  - Harmonize investment **approval processes and regulated return structures**, and facilitate comparative studies.
  - Review EU targets and timeframe to assess feasibility given the current context.

Both governments and utility companies need to work together as true partners for the benefit of all.

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