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## **Security of electricity and gas supplies becoming significant concern for European utilities**

Fundamental market forces are still pushing prices up in the European utility sector, but the advent of competition in some markets is constraining price rises overall, finds the latest set of figures from Capgemini's European Energy Markets Deregulation Observatory<sup>1</sup>. One key conclusion of the Observatory is that market fundamentals, particularly the balance between supply and demand, are exerting a stronger influence on prices in a number of markets.

Whereas deregulation initiated competition based on price, and therefore resulted in reductions in price, markets are evolving to the point where forces of supply and demand are beginning to establish prices.

Increased competition in the European utility market was triggered by the auctions of virtual power plants, gas release programmes and continued merger and acquisition activity. This activity allowed incumbent utilities to gain access to physical assets, develop a regional presence and deliver dual gas and electricity offerings.

Overall, substantial progress on utility market deregulation was seen on two fronts in 2004: the complete opening of the non-residential market and the unbundling of distribution utilities. But despite this progress, security of supply continues to be a major concern for utilities and regulators. Governments and utilities have launched initiatives to increase infrastructure capacities, notably the building of nuclear reactors in Finland and France and new investments in gas infrastructure projects in the UK.

Colette Lewiner, senior vice president, global leader energy, utilities and chemicals, Capgemini explains: "Real generation capacity margins remained tight in several countries, including new EU joiners. Several initiatives were taken to increase the cross-border capacities and exchanges in Europe. However the electricity exchange levels remained too modest to significantly decrease the threat of new black-outs in the coming years.

“Wholesale spot electricity prices were increasingly volatile and subject to big price spikes related to events such as changing weather conditions, outages of major power plants or transmission line congestion. As a consequence the security of electricity and gas supplies in the coming years is becoming a significant concern that deserves proper treatment.

Jayesh Parmar, vice president, utilities market restructuring, Capgemini explains: “Much remains to be done in defining how liberalised markets are monitored, and how additional capacity is best incentivised to meet the required margins. This whole area is very much work in progress - but the issues are very current for investment in generation, and gas import and storage facilities.”

Capgemini’s report also found that there has been notable growth in renewable generation, since the last EEMDO was published, particularly of wind power and particularly in Spain and Denmark. Expansion in other countries is more modest, but planning applications indicate that we should see substantial growth in other countries such as the UK.

The move towards “clean” energy sources will be boosted by the introduction of the Carbon Emissions Trading Scheme in January 1<sup>st</sup> 2005. This will have a more substantial impact on utilities than the current trade in green certificates. But although the initial National Allocation Plans are established, these are not initially expected to be particularly demanding of the sites affected. Trading volumes are expected to be low initially but growing with the extension of the scheme and reductions of the allowances.

Other key findings include:

**Interconnector activity:** while there has been no significant activity this year the picture is changing rapidly. There are a number of initiatives underway to establish new interconnectors or create additional capacity on existing ones.

**Wholesale markets:** the number of wholesale markets has grown quickly and there are now 11 regulated power exchanges in Europe. However the real issue is that wholesale markets are facing a lack of liquidity. More liquid exchanges would allow a real European electricity market.

**Retail switching:** Competition is progressing in all countries and after July 2004, all EU members have opened to competition their I&C market. The client’s switch rates evolve

following the stages of deregulation: when competition begins to develop, consumer awareness grows and mobility rates increase, they could drop as markets mature. Usually, mobility factors do rise in response to increases in prices.

<sup>1</sup>Capgemini's European Energy Markets Deregulation Observatory (EEMDO) is an annual report that tracks the progress of deregulation in different European countries and reports on selected indicators that provide evidence on how well the energy utility industries are functioning. The report is based on data gathered from winter 2003/2004.

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