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16th Annual Edition of the European Energy Markets Observatory: Measures adopted by the European Commission are insufficient to ensure security of energy supply for Europe

Paris, October 28, 2014 - Capgemini, one of the world's foremost providers of consulting, technology and outsourcing services, in partnership with the Research team at Natixis, CMS Bureau Francis Lefebvre and Vaasa ETT[1] today published the sixteenth edition of the European Energy Markets Observatory (EEMO) report. The study shows that in 2014, as in 2013, European markets for electricity and gas remain very disturbed notably with negative electricity prices on the wholesale markets. To address this situation, the European Commission has defined new objectives and rules which remain insufficient to restore stability and sustainability of the markets, states this year's EEMO. Security of electricity supply is threatened this year in parts of Europe, with more at risk in 2015. In addition, the security of gas supply will also be threatened if the geopolitical situation between Russia and the EU remains tense. Despite this difficult environment, the financial situation of most Utilities has stabilized.

According to this year's European Energy Markets Observatory,

1. Rapid and profound changes to the European rules of the electricity markets are urgently needed

The European Commission seems to have realized the need for reforms and has decided to modify its Energy Climate policy. Indeed, on 23 October 2014, it decided that only the major goal of at least 40% reduction in greenhouse gas emissions by the year 2030 (compared to 1990) will be broken down per Member States. At the level of the European Union, the proportion of renewable energy in the electricity mix will represent 27% in 2030 against 14.1% in 2012, and an energy efficiency gain of 27% is expected compared to 2005 projections. The latter two objectives are secondary because they are not legally binding for Member States. However, more drastic measures are needed, and the new European Commission should establish new market rules.

Colette Lewiner, Capgemini's Energy and Utilities worldwide expert comments: "*By establishing these objectives, the European Commission is responding to current market failures. However, their effects won't occur for many years. Without rapid and profound changes, negative wholesale electricity prices could still be*

[1] Natixis, CMS Bureau Francis Lefebvre and Vaasa ETT are partners of the Capgemini European Energy Markets Observatory. More information is available at the end of the press release.

observed and new gas-fired plant closures could occur. Moreover, prices will keep increasing on the retail markets, and electricity supply could gradually be threatened in many European countries."

Finally, it will be difficult to finance investments which are needed in the long run - estimated at 2,200 billion dollars by 2035 in electricity infrastructure[2].

The Utilities team within Global Markets Research at Natixis comments "*In today's uncertain environment, the lower investment budgets of utilities in Europe are for the moment a central lever for improving their financial structures*."

2. European gas supply is too fragile

Thirty per cent of gas consumed in Europe[3] comes from Russia, half of which via the Ukraine[4]. Relations with Russia therefore have a direct impact on supply. Following the crisis between Russia and the Ukraine, Gazprom[5] has ceased deliveries to this state since June 2014. This is the third cut in eight years. If the diplomatic situation between the EU and Russia remains tense, gas supplies could also be threatened this winter in European countries supplied exclusively or mainly by Russia.

The Observatory recommends the following measures to improve the security of gas supply in the European Union:

- consider the authorization of the exploration and exploitation of shale gas in order to increase domestic production,
- increase LNG[6] imports,
- build new storage capacity,
- promote pipelines which don't pass through Russia

The United Kingdom and some Eastern European countries[7] have thus launched the exploration of shale gas. Germany, which is heavily dependent on Russia for its gas purchases[8], plans to enact a law to allow the technique of "fracking"[9]. However, this technology is sometimes met with opposition from the public and some governments, such as France and Bulgaria.

[2] Estimation of the International Energy Agency
[3] The supply of gas to the European Union originates 34% from domestic production in the European Union, 30% from Russia, 22% from Norway, 5% from Algeria, 5% from Qatar, other 2%
[4] 50%
[5] Russian gas and oil company.
[6] LNG: Liquefied Natural Gas
[7] For example Poland and Romania
[8] 37% of its gas consumption originates from Russia
[9] Fracking: technique consisting of cracking a rock by injecting pressurized liquid to recover oil and gas in impermeable rocks. This technique is combined with horizontal drilling.

3. Energy transition encounters many difficulties

Germany has implemented its energy transition since 2011. The retail price of electricity for individuals experienced a very significant increase (+57%) between 2006 and 2013. Its price in Germany is currently twice as high as in France. Moreover, the massive construction of solar and wind capacity has triggered heavy investments in grids in order to transport electricity from the North Sea wind farms to the south of Germany, where the industrial zones are located. These constructions of power lines have met with a divided public opinion and burdensome administrative rules. In order to limit the electricity price increases, in August 2014, the German Parliament took measures to reduce subsidies for renewable energy and limit the number of tax exemptions for large energy-intensive industries.

Perry Stoneman, Capgemini Global Head of Sectors & Utilities comments: "*Lessons learned from the German experience should be taken into account by other EU members that are looking to develop new energy legislation. It is necessary to set a reasonable pace of renewable energy growth in order to limit the rapid increase of electricity retail prices, and preserve the competitiveness of enterprises.*"

4. Utilities need to embrace digital to truly transform

In “Horizon 2020”, the prominent multi sectoral program for R&D[10] adopted by the EU, the collection, processing and use of data are recognized as priorities in all economic sectors, including that of energy. It confirms that digital solutions are key enablers for the future.

About the European Energy Markets Observatory

The European Monitoring Centre for Energy Markets is an annual publication that Capgemini aims to track key market indicators for electricity and gas, monitor the balance between supply and demand, to measure progress in the establishment of an open and competitive market in the 28 countries of the European Union, Norway and Switzerland, as well as the progress on the EU Climate-Energy package objectives. The 16th edition is built on a majority of public data sources combined with Capgemini methodology and knowledge, and based on 2013 and winter 2013/2014 data sets. Specific expertise on the financial situation of Utilities and performance of this sector, the European energy policy and customer mobility is produced respectively by the Research team at Natixis, CMS Bureau Francis Lefebvre and VaasaETT.

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[10] R&D: Research and Development