

European Utilities Regulatory Overview

**Peter Kernan, Head of European Utilities
Westminster Energy Forum**

Sept 2006

Agenda

1. Operating environment is strong but regulatory risk is increasing
2. A perspective on the DG COMP review and Energy Green Paper
3. How Credit ratings can be affected by regulatory changes
4. Conclusion



2002-2005: Strong operating environment

(Mil. €)	--Gross debt--				--Net debt--			
	2002	2003	2004	2005	2002	2003	2004	2005
E.ON AG	22,765	19,994	18,608	12,416	14,380	9,199	6,592	-2,703
Electricite de France	29,542	29,604	25,909	29,717	24,861	24,009	19,668	10,607
Enel SpA	26,076	27,180	27,193	13,263	24,467	24,174	24,296	11,075
RWE AG	29,881	31,790	27,383	27,452	19,279	19,994	14,844	15,677
Vattenfall AB	7,112	6,691	5,947	6,314	5,422	5,080	4,437	4,818
Total	115,376	115,259	105,040	89,162	88,409	82,456	69,837	39,474

(Mil. €)	--Free operating cash flow--				--Net acquisitions--			
	2002	2003	2004	2005	2002	2003	2004	2005
E.ON AG	404	2,878	3,260	3,611	10,785	254	220	-5,051
Electricite de France	3,333	1,733	3,036	3,213	5,532	1,369	1,213	2,951
Enel SpA	-924	3,204	1,558	2,656	-1,454	754	-1,815	-4,128
RWE AG	1,838	918	1,499	1,673	11,276	2,378	-2,329	-164
Vattenfall AB	960	1,045	1,531	1,239	2,848	207	135	105
Total	5,611	9,778	10,884	12,392	28,987	4,962	-2,576	-6,287



Regulatory and Policy Challenges

Heightened political and regulatory risk:

- » Competition Commission review of electricity and gas markets
- » Liberalisation directive infringement proceedings
- » EU Energy Green Paper
- » Pressure due to ETS, lack of clarity on long-term climate policies



EU's Competition Directorate Review

DG COMP investigation launched July 2005 to assess “whether current indications of market malfunctioning result from breaches of competition law”

Preliminary report noted that main barriers to fully functioning markets are:

- (1) Market concentration,
- (2) Vertical foreclosure,
- (3) Lack of market integration,
- (4) Lack of transparency and
- (5) Price formation.

The UK and French markets present radically different market structures



Liberalisation Directive Infringement Proceedings

The main problems found include:

- persistence of regulated prices (Spain, France)
- lack of legal unbundling and insufficient separation between TSO's and DSO's (France, Italy, Spain)
- discriminatory third-party network access and insufficiently transparent tariffs;
- the free choice of supplier;
- the powers of regulators,
- preferential access through certain long-standing electricity, gas contracts (France, Germany, Italy, UK);



The Energy Green Paper

The Green Paper “A European Strategy for Sustainable, Competitive and Secure Energy”, considers that policy should have three main objectives:

- Sustainability, Competitiveness, Security of supply

The EU should continue to work with the Member States to raise awareness of the difficult choices faced and facilitate a debate on energy policy challenges

Policy making will be challenging. Member States and the EU may have different priorities and objectives can conflict



Sustainability Policy

ETS has raised prices, increased volatility, boosted generation profit

ETS favors gas over coal and increases our gas import dependency

Policy visibility is key to facilitate investment planning but is limited

Broader international participation, equitable NAP's, wider intra-EU burden sharing should be targeted

Renewables provide expensive power but do support sustainability and security of supply objectives.



Competitiveness, Security of supply

Further liberalisation would generate net economic benefits. Market pricing would however increase price volatility.

To mitigate risk, companies must spread their sourcing and LNG and pipeline supply routes and maintain a diversified generation mix.

What of coal?

- Policy should support global cooperation in clean coal and carbon capture and storage, and technology transfer.

.... And nuclear?

- If new plant is not built as facilities decommission, security and climate risk will increase. Decommissioning, safety and final storage issues key to inform the debate

Top20 European Utilities

	January 2003		January 2004		January 2005		Sept 2006	
	Rating	Outlook	Rating	Outlook	Rating	Outlook	Rating	Outlook
E.ON AG	AA-	Stable	AA-	Negative	AA-	Stable	AA-	Watch Neg
Edison SpA	BBB	Watch Neg	BBB	Stable	BBB	Stable	BBB+	Stable
Electricite de France	AA	Negative	AA-	Negative	AA-	Negative	AA-	Negative
Endesa S.A.	A	Watch Neg	A	Negative	A	Negative	A	Watch Neg
Enel SpA	A+	Stable	A+	Negative	A+	Stable	A+	Negative
Energias de Portugal S.A.	A+	Negative	A	Negative	A	Watch Neg	A	Stable
EnBW Energie Baden-Wuerttemberg AG	A+	Stable	A	Stable	A-	Stable	A-	Positive
Fortum Oyj	BBB+	Stable	BBB+	Stable	BBB+	Stable	A-	Stable
Gaz de France	AAA	Watch Neg	AA	Negative	AA	Negative	AA-	Watch Neg
Iberdrola S.A.	A+	Stable	A+	Stable	A+	Stable	A+	Watch Neg
National Grid Holdings One PLC	A	Stable	A	Stable	A	Stable	A	Watch Neg
Public Power Corp. S.A.	BBB+	Stable	BBB+	Stable	BBB+	Stable	BBB+	Stable
RWE AG	A+	Stable	A+	Negative	A+	Negative	A+	Negative
Scottish and Southern Energy PLC	AA-	Stable	AA-	Stable	AA-	Watch Neg	A+	Stable
Scottish Power U.K. PLC	A-	Negative	A-	Negative	A-	Stable	A-	Stable
Suez S.A.	A-	Stable	A-	Negative	A-	Stable	A-	Watch Pos
Union Fenosa S.A.	BBB+	Stable	BBB+	Stable	BBB+	Negative	BBB+	Negative
United Utilites PLC	A-	Positive	A-	Positive	A-	Stable	A-	Stable
Vattenfall AB	A-	Negative	A-	Stable	A-	Stable	A-	Positive
Veolia Environnement S.A.	BBB+	Stable	BBB+	Positive	BBB+	Stable	BBB+	Stable



Ratings Impact of Policy Options

Liberalisation and Ownership Unbundling of Networks Would Accelerate Consolidation and Weaken Credit Quality as:

- Transmission networks exhibit strong credit characteristics and their unbundling would weaken the credit quality of the remaining business
- Liberalisation increases price and investment risk and would accelerate M&A, which generally has an adverse impact on credit, as scale and diversity offer strategic and financial benefits.

We would expect to have a number of large, diversified pan-European generation and supply companies lead by E.ON, EDF, Enel rated in the A or BBB category depending on financial policy and strategic and financial risk.

Independent transmission companies would have strong credit characteristics. Rating would depend on financial policy, ownership structure and strategic risk

Energy security and climate policies will also drive consolidation



Conclusion

Regulatory and political risk has increased due to high profits, concern at levels of competition

While the outcome of the DG COMP and Energy Policy reviews is uncertain, an increase in competition is likely

Further liberalisation, energy security and climate change issues will drive consolidation and M&A – DG COMP role is key

Regulatory risk is expected to be one of the main drivers of ratings pressure (together with M&A)



Contact Details

Peter Kernan, Managing Director

Head of European Utilities

Tel. +44 207 176 3618

peter_kernan@standardandpoors.com