

Q&A with Lars Kjølbye

## Europe's Energy Markets: Navigating the New Commercial Reality

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Lars Kjølbye, a partner in Latham & Watkins' Brussels office, focuses his practice on complex cases in all areas of European Union competition law, including abuse of dominance, restrictive practices, merger control, state aid and energy regulation.

In this interview he discusses the changes that have taken place in Europe's energy markets during the last ten years, the regulatory and antitrust exposure facing energy companies operating in this new environment, and the impact of the US shale gas revolution on European energy policy.

### What changes have the European energy markets experienced during the past decade?

**Kjølbye:** European Union (EU) energy markets have changed fundamentally during the last few years and European energy companies are struggling to navigate the new regulatory and commercial reality.

Ten years ago, the European energy sector was essentially based on national structures, with one or a few vertically integrated incumbents in each country. In the power sector, the main generators would run a limited number of large generation units and use their own grids to deliver power to customers. It was a very stable environment. However, in order to create an integrated European energy market, the EU launched a regulatory and antitrust driven attack on these vertically integrated structures. Strict unbundling rules were imposed and a wide range of new regulatory measures rolled out. Companies are facing a more competitive and complex environment as a result.

A further transformative development is EU climate change policy, which has driven a large-scale deployment of subsidized renewables. These renewable energy sources are displacing a lot of the traditional power plants. However, since renewable energy sources are intermittent — they only generate when the wind blows or the sun shines — conventional power plants are still needed to keep the lights on. Power companies are now calling for subsidies to keep their conventional plants on stream because the economics are no longer there. A combination of high gas prices and low wholesale power prices is causing particular issues for gas-fired generation. This is a Europe-wide issue, but is particularly pressing in some countries that have gone very heavily into renewables such as Germany and Spain. In Europe, state subsidies need to be authorized by the European Commission under EU state aid rules. State aid to power generation is currently one of the hottest topics in the EU and Latham is helping clients to successfully navigate the challenges.

### What impact has the financial crisis had on Europe's energy markets?

**Kjølbye:** In the wake of the financial crisis there has been a large-scale influx of financial markets regulation into energy markets. They are traded commodity markets and therefore have many similarities with financial markets. Regulators worry about the risks of manipulation of prices and benchmarks, which we've seen in the financial sector with, for example, the LIBOR investigation. Energy companies are struggling with having to comply with a large body of new regulatory requirements that they are completely unfamiliar with.

This is not the only challenge. The dividing line between what is antitrust and what is regulatory is increasingly blurred. Companies need to comply with both sets of rules and compliance with one does not preclude action under the other. Even worse, companies can be prosecuted under antitrust and regulatory rules in parallel. There is no protection against double jeopardy. Therefore, energy companies need counsel who can navigate both the regulatory and the antitrust exposure. Our integrated approach offers exactly that.

### What does the deployment of renewable energy generation look like across Europe?

**Kjølbye:** As part of its climate change policy, the EU has set a renewables target of 20 percent by 2020 for Europe as

a whole and individual targets for each country. Targets, to some extent, take into account local factors. But still, each country needs to deploy renewables even if it is not a particularly windy or sunny place.

So you have quite a lot of renewables deployment in countries where the economics are off. For example, solar energy has been heavily subsidized in the Czech Republic despite the fact that it isn't a particularly sunny place. Unsurprisingly, it has turned out to be very expensive and the Czech government has retroactively reduced support levels to manage costs. Many other countries are doing the same, which creates a lot of uncertainty about the stability of support schemes and the economics of renewables.

The European Commission has since come out with a revised climate change policy for the period 2020 through 2030. They have now softened the national targets and acknowledged that the country-specific targets were too costly to implement. At the same time EU state aid control rules are being revised to ensure that national support schemes become more market-reflective and better at controlling costs. Support schemes will be less generous. The upside is that the new approach may well promote stability and certainty for investors going forward.

### **What impact has the US shale gas revolution had on Europe's energy markets?**

**Kjølbye:** The shale gas revolution in the United States has had a significant impact on the most recent thinking in Europe. We now realize that energy-intensive industry in Europe is at a very significant competitive disadvantage compared to the United States.

When Europe's climate change and energy policies were developed in 2006-2007, people believed that energy prices would go up globally and that renewables would become competitive quickly. There was also a belief that countries around the world would sign up to climate change commitments such that there would be a level playing field. Everybody would have symmetrically high costs and everybody would commit to climate change policy.

But what has happened in the meantime is that there has been no global agreement on climate change objectives. And you have high energy costs in Europe, in part due to renewables deployment, and low gas and electricity prices particularly in the United States due to shale gas. This asymmetry is making people very worried. The stakes are high particularly in countries such as Germany, which have a large industrial base. Therefore, there is a lot more focus now on cost asymmetries and how best to manage energy costs. European energy companies are diversifying into energy efficiency services — a clear growth area going forward.

### **How is Europe's energy policy reacting and adapting to the US shale gas revolution?**

**Kjølbye:** Europe is softening, to some extent, its climate change policies to better factor in competitiveness considerations and ensure that renewables are deployed where it makes economic sense — reducing the need for subsidies. These efforts are flanked by strict antitrust enforcement to make sure that companies do not raise prices above competitive levels. There is a new focus on the retail and distribution level, which accounts for a high share of the energy bill.

The EU is also looking to diversify gas supply sources. Whereas only a short while ago the European Commission was very critical of shale gas development in Europe because of environmental concerns, it recently came out with new guidance that is much more open to European shale gas development because it might help bring down energy costs.

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