

Contribution to the debate on the Green Paper
Towards a European strategy for the security of energy supply

Name	Nicholas Wye
Organisation	Dynegy Europe
What are you areas of interest?	Regulatory Affairs, European Energy Markets
Contact person	Nicholas Wye
E-Mail	Nicholas.wye@dynegy.co.uk
Telephone	00 44 208 334 7263
Fax	00 44 208 334 8943
Address	Parkshot House, 5 Kew Road, Richmond, Surrey, TW9 2PR, UK

Please add your answers after the question(s) which deal most closely with the subject(s) on which you wish to comment so that the Commission can deal with the remarks efficiently and swiftly.

1.	<p>Can the European Union accept an increase in its dependence on external energy sources without compromising its security of supply and European competitiveness? For which sources of energy would it be appropriate, if this were the case, to foresee a framework policy for imports? In this context, is it appropriate to favour an economic approach: energy cost; or geopolitical approach: risk of disruption?</p> <p>Answer: In terms of gas and power commodities there is no conflict between increased dependency upon external energy sources and internal security of supply. In fact, limiting the importation of non-EU supplies would compromise security and/or lead to uneconomic investment within the Community. Geographical and geological features cannot be overlooked as the primary determinants of where energy maybe sourced from, now and in the future.</p> <p>The European Commission has a major role to play in the political arena, both from an internal and external standpoint. First and foremost, it must continue to drive for the full liberalisation and harmonisation of European Energy Markets. Transparent and competitive markets will engender efficient operation of existing networks and signal the need for future supplies and network enhancement. Trading in these markets will require that participants look to broaden supply portfolios, in terms of overall volumes and flexibility. It is clear that participants competing in a market place will seek the most cost effective measures to meet demand, this principle cannot be applied to a monopolistic market. We would expect contracts struck between buyers and sellers to better share economic rents and to better reflect the dynamic market conditions e.g.</p>
----	---

	<p>flexible and responsive to short term needs</p> <p>From an external perspective the European Commission should continue in its political/relationship building function. Building on the Energy Charter and the draft transit proposal coupled with ongoing work within the INOGATE programme are excellent examples of where and how the Commission can seek to address issues which lie outside of the EC domain.</p> <p>The interaction of internal liberalised markets with established common transit and export rules with external trading parties will go a long way to meeting concerns over long term supply security.</p>
2.	<p>Does not Europe's increasingly integrated internal market, where decisions taken in one country have on an impact on the others, call for a consistent and co-ordinated policy at Community level?</p> <p>Answer: Policies relating to the energy industries can be at a number of levels. It is important that at the high level, that being pertaining to general market opening and structure, such policies should be consistent. We refer specifically to customer roll-out, third party access to transmission, cost-reflective charging for services, unbundling etc. As long as general market liberalisation policy and associated timetables are consistent we see no need to develop additional security of supply policies. As stated in response to question one, the overall EC framework should be one which seeks to nurture the development of competition and of traded markets.</p>
3.	<p>Are tax and state aid policies in the energy sector an obstacle to competitiveness in the European Union or not? Given the failure of attempts to harmonise indirect taxation, should not the whole issue of energy taxation be re-examined taking account of energy and environmental objectives?</p> <p>Answer: Taxation and subsidies do impact overall competitiveness, be that between EU and non-EU States and between EU Member States. The levels of taxation and subsidies applied do not necessarily need to be consistent and should reflect the individual characteristics of each Member State. It is important that taxes and subsidies are transparent to the market place and fairly applied. The primary objective which must be considered when seeking to impose any form of fiscal mechanism is that competition must be upheld and not comprised through the adoption of skewed fiscal measures.</p> <p>We would agree that tax and State Aid policies are in need of review to ensure that the principles established are consistent with the objective of securing effective trade between all participating States.</p>
4.	<p>In the framework of an ongoing dialogue with producer countries, what should supply and investment promotion agreements contain? Given the importance of a partnership with Russia in particular, how can stable quantities, prices and investments be guaranteed?</p>

Answer: Again, consistent with points raised before, we fail to recognise the need to establish specific obligations or agreements relating to the existence of supplies or investments in relevant networks. The form, location and cost of purchase of supplies from within and outside the EU are matters for the marketplace. Suppliers will respond to market requirements and make the necessary investments to capture economic rent. The concern over quantities and prices should be allayed by contractual arrangements put into place by the relevant parties.

Dynergy believes that the Commission has a role to play in monitoring the overall market. It should use its powers to meet legislative requirements and to identify and punish instances of abuse of market power e.g. creation or continuance of localised constraints to artificially inflate prices and continued examination of harmful, inflexible long term supply contracts.

5. Should more reserves be stockpiled - as already done for oil - and should other energy sources be included, such as gas or coal? Should the Community take on a greater role in stock management and, if so, what should the objectives and modalities be? Does the risk of physical disruption to energy supplies justify more onerous measures for access to resources?

Answer: Stockpiling of reserves would be detrimental to assuaging concerns over system security. In gas markets, “reserves” are maintained through the development and exploitation of storage, linepack and contracted flexibility. Enforced withholding of supplies would create fuzzy signals and potentially lead to perverse market behaviour. For instance, the enforced injection of gas into storage facilities, or corresponding withholding of supplies will artificially shift the supply curve. This may lead to unseasonal supply shortfalls and corresponding price spikes during periods of low demand. It is our view that as the differential between peak and off-peak prices expands then marketeers will seek to exploit the super-profits which will exist. This will be achieved through simple construction of additional peaking facilities, such as storage, or re-negotiation of contract terms. It could be foreseen that in instances where storage bookings are insufficient to meet forecast peak demands, then it maybe appropriate for the system operator to purchase the storage capacity necessary to meet the deficit. The purchase of this capacity should only take place as a last resort and should not distort the market for storage capacity.

Physical disruption of energy supplies may be caused by a number of events e.g. unexpected offshore problems, which maybe resolved in a relatively short time, or a long term cessation of supply due to, for instance terrorist activity. The former example can be dealt with through market reactions, or if needed local emergency procedures which, typically would obligate the relevant parties to maximise deliveries. The second event cannot be reconciled by market activity or emergency procedures, if the impact is significant and long-term. Additionally, any form of required stockpiling would be futile to meet a significant, long term supply shortfall. That is unless, of course the level of stockpiling was so great that it could meet such levels of demand. This would require duplication of assets and extraordinary levels of inefficiency.

6.	<p>How can we develop and ensure better operation of energy transport networks in the European Union and neighbouring countries so as to enable the internal market to function properly and guarantee security of supply?</p> <p>Answer: Transport networks tend to be monopoly functions. This is reflected by the fact that owners and operators of these networks are regulated. As a result, network ownership is a low risk business characterised, in most cases, by guaranteed rates of return. It is important, therefore, that the form of economic regulation correctly identifies the assets and the costs associated with operating the network. In addition, the TSO's should be exposed to reasonable financial incentives to drive efficient management and operation.</p> <p>In order for additional investment to be encouraged, be that by the established monopoly or from third parties, it is essential that the market is provided with accurate investment signals. This means that costs associated with maintaining and operating the existing network should be correctly identified and recovery of those costs correctly targeted. Any cross-subsidisation of activity will cloud the true costs of operation and skew future investment. Dynegy recommends that TSO's are required to produce specific activity costs at all levels of operation so that tariff structures can be designed in a truly cost-reflective manner.</p> <p>The question correctly identifies the relationship between market functioning and security of supply. In order for the market to function properly the ability to access networks, the costs associated with transporting energy through the networks and the more covert costs associated with participating in the markets eg balancing costs must be given particular attention. Charges and market rules must be transparent, non-discriminatory and cost-reflective.</p> <p>Long-term contracts are not necessarily inefficient, however, the terms of the contracts themselves are likely to frustrate the development of a competitive market. For instance destination clauses, priority access rights and general inflexibility, in both volumes and prices have, and will continue to produce significant barriers to entry for new entrants.</p> <p>Dynegy believes that the various regulators, including the EU should be far more proactive in removing these obstacles and should focus on cases where market development is being frustrated. Access to capacity is proving to be a major hurdle for new entrants either because of the quantity of capacity being released or the manner by which it is released eg first come first served. It is important that anti-hoarding mechanisms are developed and capacity trading is encouraged.</p> <p>Finally, and perhaps most crucially information regarding network operation is made available to the market. The supreme guardians of competition are the market participants themselves. Information relating to capacity availability, capacity utilisation and capacity prices, for instance, should be provided to the market to permit transparency and self-regulation of the market.</p>
7.	<p>The development of some renewable energy sources calls for major efforts in terms of research and technological development, investment aid and operational aid. Should co-financing of this aid include a contribution from sectors which received substantial</p>

	<p>initial development aid and which are now highly profitable (gas, oil, nuclear)?</p> <p>Answer: This question is very much related to question 3 as it relates to the structure and application of fiscal measures to meet desired social/environmental outcomes. The principle of taxing sectors to subsidise others must be viewed with great caution. Unless it can be shown that the level of taxation and subsidy is such that it precisely compensates for the current market inequalities then it will create an environment of regulatory risk which will penalise past investments and deter future investment. The private sector should be encouraged to develop renewable energy sources that will meet the demands of the future. It has been Dynegy's experience that the setting of renewable targets only succeeds in ensuring that the targets are met and not exceeded. Dynegy is not convinced that in such cases market demands are truly met.</p> <p>It would seem more practical, in terms of ensuring that generation is less exposed to market "blurring" that taxes are better targeted at demand. This would reduce the potential for a double whammy of misaligned cross-subsidisation.</p>
8.	<p>Seeing that nuclear energy is one of the elements in the debate on tackling climate change and energy autonomy, how can the Community find a solution to the problem of nuclear waste, reinforcing nuclear safety and developing research into reactors of the future, in particular fusion technology ?</p> <p>Answer: Dynegy does not own or operate any nuclear plants we believe that nuclear energy has a part to play in the medium to long term supply mix. Clearly, the nuclear industry does require extensive regulation, from a safety perspective and it is important that the costs of waste etc are correctly internalised. As long as the cost of production fully reflects the cost of waste disposal and safety processes then nuclear should be permitted to compete in the liberalised markets with other sources of energy.</p> <p>Similar to our views regarding development of renewable energy we view cross-subsidies and fiscal intervention with great caution.</p>
9	<p>Which policies should permit the European Union to fulfil its obligations under the Kyoto Protocol? What measures could be taken in order to exploit fully potential energy savings which would help to reduce both our external dependence and CO2 emissions?</p> <p>Answer: In general, we would support a mechanism which defines allowed levels of aggregate pollution, be that CO2 or other pollutants, and the market dictates who has the right to pollute through the introduction of permits. This would ensure that the costs associated with production, the price received for production and the cost of pollution are correctly aligned. Trading of rights to pollute would encourage the development of new-build efficient generation and the modification or termination of non-efficient plants.</p>
10.	<p>Can an ambitious programme to promote biofuels and other substitute fuels, including hydrogen, geared to 20% of total fuel consumption by 2020, continue to be implemented via national initiatives, or are co-ordinated decisions required on taxation, distribution</p>

	<p>and prospects for agricultural production ?</p> <p>Answer:</p>
11.	<p>Should energy saving in buildings (40% of energy consumption), whether public or private, new or under renovation, be promoted through incentives such as tax breaks, or are regulatory measures required along the lines of those adopted for major industrial installations?</p> <p>Answer:</p>
12.	<p>Energy saving in the transport sector (32% of energy consumption) depends on redressing the growing imbalance between road and rail. Is this imbalance inevitable, or could corrective action be taken, however unpopular, notably to encourage lower use of cars in urban areas? How can the aims of opening up the sector to competition, investment in infrastructure to remove bottlenecks and intermodality be reconciled?</p> <p>Answer:</p>
13.	<p>How can we develop more collaborative visions and integrate the long-term dimension into deliberations and actions undertaken by public authorities and other involved parties in order to evolve a sustainable system of energy supply. How are we to prepare the energy options for the future?</p> <p>Answer: The answer to this question is contained within the answers to previous questions relating to the promotion of competitive markets. All relevant public and private authorities should work to removing barriers to trade, including the removal of extensive administrative hurdles to build new facilities and networks. It is apparent that at present there are a number of virtual constraints in existence. There are, of course very real physical system constraints which limit the Communities ability to flow energy from a number of sources to various centres of demand, however, it is clear that the assets currently in existence are under-utilised. Many routes, both in gas and power categorised as congested are not fully utilised due to inappropriate allocation mechanisms and hoarding practices. It is critical that capacity is allocated in a fair and transparent manner and that hoarding practices are disqualified before it is possible to get an accurate representation of where congestion may occur in a truly liberalised energy market. We urge the Commission to continue to accelerate the liberalisation process and play a pivotal role in monitoring and acting upon instances of anti-competitive or market stalling practices.</p>
14	<p>Any other questions or proposals:</p>

Thank you for replying to this questionnaire.