

Jean-Marie Chevalier on GDF-Suez merger

The remarkable birth of a national champion

| *By Yves de Saint Jacob*

With the ink barely dry on the merger between GDF and Suez, creating the world's fourth largest gas and electricity supplier, French President Nicolas Sarkozy has set the wheels in motion for the restructuring of the nuclear power industry, based around Areva and with the same aim – to give France a world-class player in a sector undergoing something of a renaissance.

Thus, the outline of the new French energy policy is taking: privatisation measures and adaptation to world markets and European competition rules, but at the same time the retention of national giants with a management keenly aware of the 'political' consequences.

The genesis of the GDF-Suez merger goes back to a deliberate intention to defend national interests. It was in the face of a takeover bid for Suez by Italian electricity company ENEL that former Prime Minister Dominique de Villepin personally announced the merger plan.

Having been elected president, Nicolas Sarkozy reviewed all the options. A merger of EDF and GDF was considered and abandoned when Prime Minister François Fillon became aware of the extent of the flak France would get from Brussels. The option of a partnership with the Algerian gas company Sonatrach proved unworkable and was even opposed by Algeria itself.

The French then went back to the drawing board and the original idea of the merger between GDF and Suez, with a public shareholding of 35%.

Will Sarkozy apply the same model for the nuclear sector, in merging a public company (Areva) with a private partner, in this case Alstom, whose main shareholder is building and civil works giant Bouygues? The question is altogether more delicate. Certainly, Areva needs finance for the launch of new projects. But there are two weighty constraints. First is the need for nuclear safety, in the civil domain as much as in the military at a time of great international instability in the sector, makes relinquishing public control dangerous. Second, Areva's current partnership with the German company Siemens is no mere joint capital venture. It is the fruit of a very long Franco-German cooperation,

born after the Chernobyl disaster and is emotionally-charged. (See the interview with Jean-Claude Lény.)

European Energy Review spoke with Jean-Marie Chevalier, Director of the Centre de Géopolitique de l'Énergie et des Matières Premières, author of numerous energy books, and one of the foremost energy experts in France, about the GDF-Suez merger.

You have always been a firm believer in the merger of GDF and Suez. What will be the major assets of the future company?

This merger is remarkable. It signifies the birth of an enterprise finely balanced between gas and electricity. Thanks to the complementary nature of the two companies, GDF-Suez will be one of the main players in the gas-and-electricity oligopoly. Unlike EDF, which is particularly dependent on nuclear energy, GDF-Suez can call on nuclear power (6 Suez nuclear power stations in Belgium), classic thermal plant, gas turbines and hydraulic power.

It will provide serious competition for EDF in France as it is able to offer a global gas-and-electricity package. That sort of competition could force EDF to develop its gas provision and it will no doubt stimulate innovation, as much in the field of technology as in energy conservation and contractual conditions.

As a multi-energy group, GDF-Suez will also benefit from its geographic spread. It has a strong presence in the Europe of 6 or 8, and more recently has moved into the Eastern bloc countries. The only black hole in Europe remains Germany, where, despite the total liberalisation of the market, it is still extremely difficult to make any inroads.

It is also a group which, because of its size, will have a great deal of negotiating power with regard to Algeria, Russia and other eventual suppliers. That power is all the greater because GDF-Suez is the only provider which can be competitive in gas through pipelines and liquefied natural gas (LNG) via boats. (Italy's ENI can do this too, but it doesn't provide electricity as well.)

Finally, and this is fundamental, the new company will be the world leader in LNG (liquefied natural gas). This market is expanding

rapidly. On the one hand, the production of gas in the United States has reached its ceiling; it will probably even diminish, as happened in the past with oil. At the same time, however, American demand for LNG, from all sources, is not in decline and will certainly increase in the years to come. On the other hand, the needs of the Japanese, Koreans and Chinese will all increase. We are witnessing an unprecedented globalisation of the market for LNG.

What is the role of GDF-Suez in this globalisation?

In the globalised market, GDF-Suez is strong due to its storage units, a distribution infrastructure second to none as well as a 'worldwide' geographical presence. The company is probably the only one in the world to have such a strong American presence – two more terminals are planned there. It has a strong position in Europe. Thanks to Suez, it is present in the Middle East, a region which is the axis of interconnection between the Eastern and Western markets. Finally, it is also present in Asia, particularly in India and Thailand. In a word, GDF/Suez is present everywhere where the gas markets are expanding.

This situation gives the company the capacity for gas price arbitrage, at any given moment in relation to the state of the market. Perhaps a trifle cynically, you could tell the European authorities in Brussels that the new company is operating in a global market. It is up to it to make the arbitrages it considers necessary. All the more so because in the case of gas, we are witnessing a multiplication of swaps.

Can you explain this notion of 'swaps'?

We can illustrate it with the following example: Italian group ENI, which has signed a contract with Nigeria for the supply of gas, is behind schedule in the building of regasification facilities. The supply of gas is directed by mutual agreement at the GDF-terminal at Montoir-de-Bretagne. In return, GDF-Suez will supply gas, probably Russian, to the Italians for their immediate needs. But it will cover itself financially over the risk of the Nigerian gas. These days, 'swaps' between gas companies, and more generally in the energy market, are a very lucrative market and GDF-Suez, present on all five continents, is a major player. 'Swaps' offer gas suppliers greater flexibility in the management and optimisation of their resources. Hence their distrust of the 'unbundling' or separation of transport and distribution advocated by the Commission.

On the other hand, the merger forced Suez to restrict its environmental activities, which was first opposed by Suez boss Gérard Mestrallet.

But the spinning off of the Suez environmental sector is only partial. The future group will retain a share in the environmental business. Such a solution they have reached is quite simply brilliant! And Mestrallet was right not to make it a complete 'spin off'. Because in the years to come, we can expect an explosion in the demand for electricity and water. Due to climate change and also because of the increase in the world population, particularly in those areas where water is scarce, the demand for water will increase. In North Africa, in the Middle East, in Asia, particularly



Photo: JP Pouteau.

*Gaz de France's chief executive Jean-Francois Cirelli, Chairman and ceo of Suez Gerard Mestrallet and president of the National Assembly Commission Patrick Ollier (left to right) announce the Suez-GDF merger, September 2007.
Photo: Antoine Gyori.*

GDF SUEZ

in China, the need for water can only be met by the desalination of sea water. Desalination necessarily entails the construction of a large number of gas or nuclear power plants. Faced with that prospect, GDF-Suez which retains a near 35% stake in the environmental subsidiary, will be well placed in the long term to regain control.

GDF-Suez is in a strong position in terms of transport, transformation and distribution. Where is it in terms of its own production of gas?

GDF decided, eight years ago, to equip itself with its own supplies. At the time I was very doubtful of the ability of a small gas supplier to break into the realm of the large oil companies in the field of prospecting and production. But they did it. They succeeded. Today GDF produces nearly 9% of the gas it sells. GDF makes a lot of money on these supplies, even if it is of no benefit to the French consumer as the gas is sold on the international market.

The supplies are from diverse sources, from Norway, Denmark and they are currently developing very considerable deposits with Sonatrach in Algeria. In this context, the merger with Suez will give it more financial means to develop this sector. To gradually provide itself with additional resources of its own makes a lot of sense to me.

Let us go back to the negotiating power of the new company. Can it really improve the assurance of supplies for France and Europe?

We have seen that its negotiating power has increased by its size, by its capacity to be competitive in gas through pipelines and LNG boats. It has also increased through its financial power, which enables it to construct new infrastructures – new roads, for example, to enable it to go and seek out gas at source. It can diversify its sources beyond Russia, take part in the Nabucco project, a pipeline which transports gas from the Caspian Sea and Iran as far as Austria, via Turkey. This diversification is one of the keys to assuring supplies for France as well as for Europe. Europe's solid foundations in the electricity and gas sectors will be further strengthened by new interconnections. The Eastern bloc countries continue to be vulnerable because of their reliance on Russian gas even if it will all work out in the end. But it will take time.



Suez brings nuclear capacity to the new company. Can we envisage that in the future GDF-Suez will decide to build nuclear power stations in France?

Yes, of course. Suez has even bought land in the Rhone-Alps region, near Pierrelatte in the Drome. For the time being, they do not have the right. But the law will certainly change. In the short term, there is more likelihood that GDF-Suez will build nuclear power stations in Britain where the nuclear debate has reopened. Eon, EDF and Suez are all candidates. In France, it is slightly more complicated because with the planned EPR (European pressurized water reactor) – which provides an extra 1,600 MW – and with the energy savings we have to make to meet EU restrictions, the need for increased nuclear capacity has not been established.

Obviously, there remains the problem of replacing existing power stations. That will come slowly, I believe, as they are likely to last longer than anticipated.

Nicolas Sarkozy and his government have begun to study the question of restructuring the nuclear industry. Areva needs to be reorganised. Can one envisage the new company GDF-Suez playing a role in the restructuring of Areva?

In my view, no. Sarkozy's plan is to restructure our nuclear capacity by leaving EDF as the operator. When it comes to construction, Areva could link up with other partners, possibly Alstom and Siemens. In this sector, you can always privatise. For the production and treatment of fuel, many people say it should be left in public ownership, keeping a sensitive area under state control. The question about the mining sector is whether it should be left in the hands of Areva or sold to Total. Total is interested. Their chairman, Robert de Margerie, has expressed an interest in the nuclear sector. People have suggested Total might



build nuclear power stations. But that doesn't make any sense. However, Total could be involved in the mining work.

Now we come to the delicate matter of France's position in relation to European policy. The Commission recently published documents designed to push Europe towards a single energy market, without the functional problems still evident at present. One of the proposals is the unbundling of ownership of the gas and electricity transport networks in the European Union to make them independent of production and supply. Certain countries, like Britain, the Netherlands and Spain, have already done so. Others, like France and Germany, are dragging their feet. How do you evaluate this move towards a single energy market?

It is all progressing, but very slowly. Don't underestimate the extreme inflexibility of the structures, the pipelines, the boats, the electric wires, power stations, human behaviour, from the consumers to the unions. It has taken 10 to 12 years of patient hard work since the first two directives on electricity and gas.

I am a member of the Economic Analysis Council and I have written a report at the request of the French Prime Minister on the gas and electricity markets in Europe. In it, I make a clear distinction between gas and electricity.

On electricity, I suggest the rapid creation of a European transport network. We have a totally interconnected system but it isn't working very well. There was the famous blackout of November 4 and there will be others. We have a need for coordination and centralised management.

Therefore, I am in favour of the rapid creation of a European electricity transport network. That would entail the property unbundling in France and other countries, at least in those of the 'hardcore' of the 'continental block' (France, the Benelux countries, Germany and Austria). But the Germans aren't ready

politically and EDF is stalling on all counts. However, if you want to create a single European energy market, you have to move towards a single network.

With what status?

It doesn't matter who the shareholders are, but you must have a single management.

And for gas?

I am less worried about gas. Because the balance of the European gas network and therefore the guaranteed supply are in the hands of five or six companies who know each other very well. And it works. If we were to go for property unbundling, there would be a danger of letting in investment funds that want a quick profit and so could put the guarantee of supplies at risk. Also, the supply is governed by long-term contracts which are very inflexible.

There is also a physical reason for drawing this clear distinction between gas and electricity. Electricity travels at 300,000 km/second, according to the line of least resistance. Gas travels at 30 km an hour through a network where there are very few routes. That traffic has to be controlled. A single system for gas is also possible but it would take longer.

In the European Commission proposals, there is also a plan to create a European regulator of energy. What do you think of the idea?

It is a good one. There is already ERGEG, the association of energy regulators. We need to move towards a single regulator. For electricity there is ETSO, the association of network operators. We also need to reinforce its powers and its coordinating role. To move towards the single system I have outlined.

You have highlighted the slow pace of the process. Who is responsible? Governments? Public companies? Market forces?

There are still many national interests at work. Putin was right when he said, 'If I were to call Europe, there would be no-one at the other end of the line.' Everyone is trying to gain an advantage here and there.

But all the same there have been changes. The European Union has set a clear aim of cutting greenhouse gas emissions by fixing three goals to be reached by 2020: 20% of renewable energy in the energy mix, 20% energy saving, 20% improvement in energy efficiency. This compartmentalisation into 'three times 20' causes all manner of problems and without doubt the goals will not be achieved. But it is an interesting move for Europe as it is a step in a positive direction. It is a major change. The Commission's initial philosophy was that the markets were capable of resolving all our problems. Now, that is no longer the case, and that is very important.

But there has also been a political revival in the consumer nations. We will see that in the United States just as we have seen it in Britain with Tony Blair who addressed the energy question head-on. Angela Merkel is doing the same and in France Nicolas Sarkozy is in the driving seat. They are no longer allowing the companies and markets to act alone. ■

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