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COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

First reflections on the development and the protection of energy
investment in the Community

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FIRST REFLECTIONS ON
THE DEVELOPMENT AND THE PROTECTION OF ENERGY INVESTMENT
IN THE COMMUNITY

1. Since the beginning of 1975, Community institutions, including the European Investment Bank, have made available around 600 M.EUA per annum of loan finance to the energy sector principally by borrowing and relending. This amount has been divided in about equal proportions between projects in the field of coal production, oil and gas production and distribution, and electricity production and distribution.
2. On 29 March 1977, the Council adopted a Euratom loan scheme which initially provided for the lending of the sum of 500 M.EUA to nuclear power station projects and to industrial nuclear fuel cycle installations (including uranium mining).
3. This level of activity, if maintained at the present level and in real terms until 1985, would imply that 2 - 3 % of the total requirements for finance for energy investment which have been forecast by Member States for the period 1976 - 1985 would be channelled through Community institutions.
4. For the reasons given below, the instruments by which the Community gives support to investment in the energy field could be usefully strengthened in three ways:
 - (a) additional lending and loan guarantees;
 - (b) development of risk sharing in appropriate cases;
 - (c) encouragement of long-term contracts to reduce the investment risks of Community producers.

Community loans and loan guarantees in the energy sector

5. By borrowing on the international capital market for relending, the Community's institutions can both increase the volume of loan finance for investment in the energy sector and, in some cases, make it available on more attractive terms than the individual enterprise could obtain.
6. However most of this is at present done under EIB or ECSC auspices, and the scale of lending is limited by the need to maintain the Community's borrowing status. Difficulties may arise if there is too large or too rapid an increase or if funds are channelled predominantly towards energy enterprises most in need of additional finance.
7. Subject to a more detailed technical and financial examination, the Commission considers that loans and loan guarantees secured on the general budget of the EEC and the EAEC can be one way to overcome these problems - firstly through direct lending or guarantees, and secondly through guaranteeing loans by the other Community institutions, to help maintain their borrowing status on the market. The newly decided Euratom loans are a first step in this direction.
8. As far as the need requires and the capital market permits the activity of the Community's institutions in this field can be increased provided that Community loans and loan guarantees are complementary to and not competitive with the efforts of individual member states and enterprises, and that there are no unacceptable budget implications consequent upon the granting of such loans or loan guarantees.
9. The overall problems of increasing Community loans and developing loan guarantees will be dealt with in a separate communication of the Commission. The present paper discusses the need for loans and loan guarantees in the energy sector only.

The nature of financial requirements in the energy sector

10. Forecasts made by member states foresee a likely investment of about 220 - 230.000 M.EUA (1977 prices) in the energy sector during the period 1976 - 1985. This would represent about 25% of all industrial investment in the Community. The Community is likely nevertheless to fall short of its objective to reduce dependence on imported energy to 50% of total requirements. To achieve that objective by 1985 or soon after, investment may have to reach levels up to 20% more, or around 260.000 M.EUA.
11. A number of factors will make it hard to realise such high levels of investment in practice. They can be summarized as follows:
 - (a) on present indications, the slowdown in investment in the nuclear and electricity sectors may not find adequate compensation in increased investment

elsewhere - in coal and energy saving for example. Instead there may be a reduction in total investment in the energy sector;

- (b) those countries who are or who will be most dependent on imported oil are often those in which it is the most difficult to amount the required investment effort, not least because of the balance of payments problems created by the cost of imported energy;
- (c) there are limits to the credit-worthiness of individual enterprises which are accentuated in sectors where the investment effort must be large in relation to past levels of activity and where the ability to auto-finance investments is tending to decline;
- (d) there is an inertia built into patterns of fuel production and consumption which creates commercial risks in some sectors where a particular investment effort is now required. To these, in some cases, must be added important technical risks. The capital market may not be well-equipped to provide risk capital on the scale required.

12. Based on these broad considerations, the Commission is examining at present an extension of the activity of Community institutions for a number of specific purposes. Three areas of immediate interest can be identified. First there will be a continuing need to facilitate the availability of loan finance to the nuclear sector. Secondly there may be a series of proposals designed to encourage energy transportation, e.g. by financial participation in inter-connections between oil and gas pipeline networks in the Community. Thirdly loan finance from Community sources could be required to support investment programmes for energy saving, e.g. the medium-term programme to save energy by modernising existing buildings which is proposed by the Commission.)*(see also Annex I).

13. It has emerged from this analysis that a substantial increase in the level of borrowing for relending or of loan guarantees from the present level of 600 M.EUA per annum seems to be necessary. This includes an assumption that the present authorisation of 500 M.EUA for the Euratom loan scheme will be renewed in 1979/80.

14. In special cases, further measures such as interest rebates may be required to ensure that funds are concentrated predominantly towards areas of greatest need.

*) Doc.COM (77) 186

An examination of risks in the field of energy and their consequences

15. Up to now, the risk of loss to Community institutions on loans in the energy sector has been minimal, because the loans have been fully covered by guarantees given by Member States Governments or by first class pledges of assets and premiums paid into a guarantee fund.
16. In future, there will still be a large number of projects for which full guarantees can be obtained. Most of a future level of borrowing for relending and of loan guarantees might be expected to be projects of this kind. However there are other projects, worthwhile from an energy policy viewpoint but containing an element of risk, where a Community guarantee, which might be secured on the EEC budget would permit the lender (EIB, ECSC or private sector bank) to accept less rigorous guarantees (such as a lien on oil in the ground) from the borrowing enterprise.
17. For these projects, provided the financial need and energy importance was clearly established, the Community could offer the lender a guarantee that in case of default by the enterprise, the Community budget would take over the obligations to the lender for repayment in their entirety. However it is recognised that for such a scheme to be workable, the risk of loss to the Community budget would have to be defined and limited very precisely. There would be a double limitation - first as to the kind of risks for which the Community guarantee would be offered, secondly as to the share of the liability arising out of the risk which would be shouldered by the European Community.
18. A distinction exists between four kinds of risk:
 1. The risk of technical or geological contingencies which delay the start of production, reduce the capacity of the plant or even result in it being abandoned.
 2. The risk of cost escalation during the plant construction period.
 3. The risk of operating losses during the plant's operation because of changes in market conditions.
 4. The risk of exchange losses due to unforeseen movements in exchange rates where monies are borrowed on the international market.
19. Certain kinds of risk can be excluded - notably risks of loss arising out of currency exchange rate movements or changes in tariff policy or taxation, which must be dealt with by the Member States. Risks arising on projects outside the Community's jurisdiction (e.g. coal or uranium exploration in

third countries) have to be examined with particular care.

The rôle of an energy pricing policy and long-term contracts

20. The long-term upward trend of energy prices is itself an insurance against risk of loss. Nevertheless progress towards an energy pricing policy for the Community would provide an other element of stability and predictability to the economic evaluation of a project, and thus reduce the risk of loss for energy investors in general and by that for the Community's budget. [It is in this spirit that the Commission formulated, in January 1976, its proposals for the fixing of a minimum safeguard price for oil.

21. Long-term contracts can also, in appropriate cases, reduce risks, particularly where it is possible to agree that, over a period of years, a specified minimum quantity of the fuel will be made available, and will be bought at, a minimum purchase price.

This gives the buyer the advantage of security of supply at predictable cost, and it gives the producer a secure outlet on which to base his investment decisions.

22. The Community has an interest in creating a more attractive environment for such long-term contracts, so as to encourage the development of the Community's energy resources in the framework of Community requirements.

To that end it is proposed that the Council adopts a number of principles of policy which are set out in paragraph 24 below, within which enterprises will freely decide whether or not to engage in long-term contracts on the basis of their own commercial criteria.

23. The main practical difficulty will be the question of price. It is not suggested that in present market conditions it will be possible to quote a fixed price for supply for a number of years, under a long-term contract. However it should often be possible to fix a guaranteed minimum purchase price, which would be below expected world market prices but sufficiently high to give security to the investor, together with a formula for calculating the normal trading price.

Where contracts reflect a real element of risk sharing between producer and user, extending perhaps to joint participation in the financing and the management of the project, the price formula for calculating the normal trading price could offer preferential terms by comparison with expected movements in world market prices. Examples of contracts with an

(*) COM (76) 20 final

element of burden sharing already exist in some areas of high technology such as the provision of uranium enrichment services, and they could be usefully extended to other areas where the technical risks are perhaps less but where the commercial risks remain large. The opening up of new coalfields or relatively high cost oil and gas fields could be cases in point.

24. The Commission would like the Council to examine the following principles of policy:
- (a) The Council should recognize that the adoption of a minimum safeguard price for oil will, by providing a "safety net", limit possible losses for Community energy supplies and facilitate the negotiation of long term contracts.
 - (b) Member States able to export energy should give a clear idea of the volumes and types of energy they could envisage providing on a long-term basis;
 - (c) the exporting Member States should give an undertaking that, whatever the conservation policies pursued, at least the contracted minimum volume to be purchased could be produced for delivery during the contract period, in conformity with the contract conditions;
 - (d) the Community could support such long-term contracts by a system of loans and loan guarantees with an element of risk sharing, or by making loan finance available on preferential terms;
 - (e) terms of contracts should be in accordance with the Treaties.
25. Examples of possible long-term contracts in each of the main sectors of energy production are given in Annex II.

Conclusions and proposals

26. It is clear that there will be a massive continuing need for energy loan finance. The Commission believes that there is added need and potential for Community lending, and for offering loan guarantees, even where there is a risk of loss, provided that risk is defined and limited, and fully justified on a case-by-case basis.
27. Complementary progress towards a Community energy pricing policy is suggested in two directions: the adoption of a minimum safeguard price for oil and of a series of principles of policy designed to create a more attractive environment for long-term contracts.

This approach is in accordance with the guidelines drawn up by the European Council at its meeting on the 1st and 2nd December 1975, the proposals

submitted by the Commission on the implementation of those guidelines in January 1976 (*), and the subsequent discussions in Council.

28. The Commission will shortly be making proposals for a programme of loans and loan guarantees secured on the Community's budget, for all purposes. The proposals will examine in detail the working of such a scheme, the manner of its introduction and the eventual scale on which it could be envisaged for all purposes.
29. The Council is invited to:
- (a) agree that, subject to general agreement to an extension of Community loans and loan guarantees, and to the drawing up of a detailed scheme, total Community support for energy projects should be increased in an orderly and progressive fashion.
 - (b) agree that, in the energy sector, such loans or guarantees could be extended on a case-by-case basis to projects where there is a risk of loss to the EEC budget provided that the liabilities so incurred be suitably defined and limited;
 - (c) agree that the Commission should be invited to identify eligible projects, with the assistance of the Energy Committee;
 - (d) endorse the proposed principles for long-term energy contracts in paragraph 24 of this paper, and to invite Governments to facilitate such contracts both by public and private enterprise.

CURRENT AND POSSIBLE FUTURE USES FOR LOAN FINANCE FROM
COMMUNITY SOURCES IN THE ENERGY SECTOR

I. Current uses of loan finance from Community sources in the energy field

1. The current level of activity by Community institutions in the energy field can be summarized as follows :

In the coal sector, E.C.S.C. loans have amounted to some 490 meua between 1974 and 1976 and E.I.B. loans to 30 meua making a grand total of some 520 meua between 1974 and 1976. In the oil and gas sector, the E.I.B. has lent some 640 meua between 1972 and 1976 at an accelerating annual rate.

In the electricity sector, E.C.S.C. loans for coal-fired power stations have been barely significant though they could increase in future. The E.I.B. has lent some 710 meua for nuclear power stations between 1972 and 1976, and a further 410 meua for non-nuclear power stations, making a total of some 1120 meua between 1972 and 1976.

2. The significance of these figures can be illustrated as follows :

Table 1 : Comparison of Community finance with total financing requirements

Sector	Recent average annual rate of Community financing meua (1)	10 year total at current rate for Community financing meua	10 year investment requirement in the Community 1976-85 meua
Coal production	210 (2)	2,100	7,800 (3)
Oil and gas	210 (2)	2,100	70,000
Electricity	220	2,200	131,000
Energy saving	-	?	?

(1) This table is only illustrative of broad orders of magnitude and therefore the figures quoted have been rounded to the nearest to meua.

(2) An average of the 1975 and 1976 figure has been taken as being more representative of the future.

(3) Lignite excluded.

SOURCES : COM/ENER 15/76 COM/ENER 7/77 SEC (77) 1060/2

II. Possible future uses for additional loan finance from Community sources.

3. Table I shows a total, for the period 1976 - 1985, for the provision of loan finance by all Community institutions of the order of 6.000 M.EUA, assuming that current levels of activity are maintained.
4. In addition to the Euratom loans scheme, there may be a need to make loan finance available on preferential terms to the nuclear fuel cycle. Loan guarantees with a risk of loss to the Community's budget may be an appropriate instrument here. Such guarantees could also be extended, at a later date, to companies developing natural uranium resources for Community users.
5. In addition to loans for oil and gas pipelines, loans with preferential conditions may be required, to support the development of transnational electricity interconnections where new technologies are envisaged.
6. Loan finance on preferential terms may also be necessary to promote new market outlets for coal, and above all coal-fired power stations for which an initial proposal has already been made. Further, relatively small amounts may be directed towards developing geothermal power stations.
7. More speculatively, loan finance with preferential conditions may be required to promote the development of external coal resources for Community use. The scope for such activity will depend on future decisions about the rôle for coal in the Community's energy strategy.
8. In the oil and gas sector, financing problems could arise if the European Community deliberately set out to increase the rôle of small and medium sized European companies in exploration and production. However at present levels of activity and with the present mix of companies, no particular need for such finance exists.

Some sector samples of long-term contracts

Nuclear fuel supply

1. Long-term contracts are already standard practice for a large part of the nuclear fuel supply cycle and the Commission possesses a great deal of information about market conditions by virtue of the Euratom Supply Agency. However the Community could play a more active rôle in encouraging Member States and the associated enterprises to collaborate in making such long-term contracts possible, especially those which reflect an element of burden sharing and mutual solidarity. The scale of transactions between Member States relating to uranium enrichment and reprocessing could become very important by the 1980s.

Coal

2. Recent discoveries, above all in one Member State, suggest that there is also a potential for relatively large levels of trade in coal between Member States by the late 1980s, to the extent that exporting Member States are well supplied from other indigenous sources and nuclear energy.

3. Given the perspective of rising real prices for energy and possibly shortages of oil in the world market, countries which do not have domestic resources of coal may be interested in encouraging long-term contracts for the supply of coal from relatively well-endowed Member States.

Oil and gas

4. There is already considerable trade between Member States in gas but the further development of that trade depends upon decisions relating to gas pipelines. The economics of these very costly projects are critically dependent upon an assured market for the gas so transported, and there is therefore a clear interest in promoting long-term contracts in this field.

5. In the oil sector, a considerable increase in trade in refined oil products is to be expected in the early 1980s, and there may be interest in putting a proportion of this on a stable long-term basis. This would certainly facilitate the financing of the high cost fields and make a significant contribution to promoting further exploration and development.

6. A system of long-term contracts backed up by a guideline set of principles of the kind described in this paper might be usefully extended to selected Third countries in close geographical proximity.