

## **Business Europe: East European Energy Companies Are at the Gates**

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Romanian racing sensation Mihai Leu is motoring around these days with the logo of the Rompetrol Group, the largest private petroleum company in Romania, adorning his rally car. The slick, Western-style mass marketing by Rompetrol comes as East European energy companies are accelerating their plans to pursue customers in the European Union. The Romanians, Slovaks, Czechs and others -- in various stages of privatization -- are poised to offer electricity, natural gas and oil to customers throughout the Continent.

And it is precisely this aggressive, Western-style approach to building brands and wooing customers that's making the incumbent players in Western Europe's energy markets nervous. In response, some -- especially in Austria and France -- are responding by trying to paint these would-be competitors as precisely the sort of backward, old-fashioned Soviet-era companies they are not.

The question then is not whether the East Europeans are ready to compete, but whether their Western counterparts can take the heat. Will Brussels stand up to the protectionists within the EU (now encouraged by George Bush's example with steel, no doubt) and defend the East Europeans as they seek to join the single market, or will the former Soviet satellites be hung out to dry?

Last week, France made headlines by defying the other 14 members of the EU in announcing that it would refuse to meet the Commission's timetable for liberalizing its electricity market. Many interpreted this as a way to protect French jobs and avoid competition from Germany and Spain. Even more frightening, however, is the gathering horde of East Europeans, many of whom have extremely low cost structures and plenty of excess capacity, much like EDF itself.

In Austria, the Freedom Party, a member of the governing coalition, has made a major issue out of the Czech nuclear plant at Temelin. The Freedom Party claims it has environmental concerns, but some say Austria is at least as worried about defending its incumbent hydroelectric generator, Kelag, as it is about being "green." If so, we can expect to see more objections to East European energy on spurious environmental grounds as EU enlargement -- and the attendant competition from the east -- looms nearer.

"The European Union countries are becoming increasingly picky about the sources of their power generation," says Simon Allen, president of ICF Consulting Europe, a policy consultancy, based in London. "There are issues regarding the import of power which is being generated by nuclear plants, and concerns about 'dirty electricity' which is generated by plants which have low efficiencies. We suspect that those concerns are set to increase quite significantly."

It wasn't supposed to be this way, notes Samantha Hampshire, a partner in the energy law practice in the London office of Baker, Botts LLP. The EU's directives on energy and electricity deregulation were supposed to usher in an era of competition -- driving down prices for companies and consumers alike.

"But countries like France are trying to create one or two major companies which will be able to survive that competition," says Ms. Hampshire. "They're still in a transitional phase. They haven't

fully implemented the liberalization directives from the EU. So they don't want to allow competition into their domestic markets."

They're also using their influence with EU policy makers to make it harder for the East Europeans -- such as Czech's coal-fired energy giant, CEZ, and Romania's Rompetrol -- to make a market for their excess capacity. It's only going to get worse. "We expect more preconditions on the import of power from Eastern European countries to be set," says Mr. Allen. "We'll probably see them limit the power imports, and increase pressure on Eastern European companies for investment in environmental technologies." That will drive up costs for end users, and may even discourage investment in new capacity for some energy producers.

Austria is at the forefront of this kind of enviro-protectionism. The country today principally sources its electricity from hydroelectric power plants, and other "clean fuels." To combat the competition from the east, the energy industry there has drawn up a black list of 15 non-EU countries whose electricity is deemed too dirty. Energy from companies in countries like Slovenia, Croatia and Hungary is simply not wanted. "But potentially the supply of energy from those countries could be at a cheaper price than Austria could generate itself," adds Mr. Allen.

Some players seem to be taking the bureaucratic games in stride. "A lot of this may be negotiation for establishing the energy market's parameters after Poland, Estonia, and others join the EU in the coming years," says Kevin Connor, managing partner in the energy law practice of Squire, Sanders & Dempsey, based in Bucharest, who worked with Slovak Electric on its restructuring and refinancing.

Mr. Connor has also worked with energy concerns in the Czech Republic and in Hungary -- and he notes that there is a raft of legislation going through the parliaments of East European capitals to further restructure their energy industries. Controversy surrounded CEZ's attempt to spin off its coal-fired Tusimice-I plant -- and industry and legislators in the Czech Republic are restrategizing to cope with the concerns of Western Europeans, he adds.

The speed bumps being laid down by bureaucrats aren't slowing down the truly entrepreneurial East European firms, though. Rompetrol owns two of Romania's 10 oil refineries -- and is looking to grow its oil and gas business, says **Colin Hart, chief operating officer of Romania and Moldova Direct Fund, LP, a Washington, D.C.-based investment firm that is heavily invested in Rompetrol.** The company owns Vega, a refinery that processes 600,000 barrels of crude oil per year; and PetrolMedia, the Black Sea-based refiner that handles 4.5 million barrels a year. "Most of the competition is still owned by the government or is owned by groups that aren't improving their performance," says Mr. Hart, adding, "There's room for growth domestically here too."

The Eastern Europeans shouldn't have to look inward, however. EU expansion promises expanded opportunities for both east and west, as long as protectionists don't derail that promise. While it's not surprising that the laggards in France and Austria are trying to erect barriers to entry to their markets -- that's a tested method of the timid. But Brussels, which has no vested interest in the existing monopolies, needs to lead if the promise of enlargement is to be fulfilled.

Let's see if Brussels has the energy for that.

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