



Brugge

College of Europe
Collège d'Europe



Natolin

The EU Climate and Energy Package and E.ON: A two-step response to a disruptive policy

Alisa AKUTSINA, David RINALDI and Thibault ROY



DEPARTMENT OF
EUROPEAN ECONOMIC STUDIES

Bruges Series on European Business Cases

03 / 2016

The **Bruges Series on European Business Cases** collects business-oriented case studies which analyse the two-way interaction between the European Union and the world of corporate or non-profit enterprises in Europe.

The Series is meant to promote business education with a European dimension and encourage the use of case methods and discussion on key strategy and business issues which are affected by EU regulation, liberalisations and common policies of the European Union.

EDITORS

Prof. Phedon Nicolaides

Prof. Aimé Heene

Prof. Philippe de Buck

Prof. Jacques Pelkmans

Dr. David Rinaldi

Thibault Roy

ACKNOWLEDGEMENTS

The authors are grateful to Professors Aimé Heene, Jacques Pelkmans and Philippe De Buck for the guidance provided and to Vera Brenzel and Tobias Pabst for their valuable comments on an earlier version of this business case. The authors remain the sole responsible of the opinions expressed in the text and of potential inaccuracies.

DISCLAIMER

Cases are intended to include publicly available data. If, however, the case contains confidential information, an approval has to be obtained from the enterprise. The cases remain intellectual property of the author(s); however, interested organization(s) can contact the European Economic Studies Department of College of Europe to remove sensitive data or to ask permission of reproduction.



College of Europe
Collège d'Europe



Natolin

Bruges Series on European Business Cases

The EU Climate and Energy Package and E.ON: A two-step response to a disruptive policy

Alisa AKUTSINA¹, David RINALDI² & Thibault ROY³

Abstract

This business case analyses why and how E.ON reacted to the EU climate regulations and to the changing environment of the European energy market. In December 2008 the European Parliament adopted the EU Climate and Energy Package to significantly decrease greenhouse gas emissions by 2020 and to promote renewables. The overcapacity on the market and the drop of wholesale price of electricity hit traditional oil, gas and coal energy utilities such as E.ON. The fast development of renewables also impacted the market structure. Faced with a disrupted market, E.ON carried massive losses. This business case analyses the corporate answers to this profoundly changing environment, from 2008 more common responses to E.ON's drastic decision to split in two firms in 2014.

¹ Analyst, International Operations Directorate, National Bank of the Republic of Belarus

² Research Fellow, Energy Climate House, CEPS

³ Academic Assistant, European Economic Studies Department, College of Europe and corresponding author: thibault.roy@coleurope.eu

Table of contents

1. Introduction	5
1.1. The power sector in the EU and E.ON.....	6
2. The EU energy and climate package and its impact.....	7
2.1. Policy objectives and instruments	7
2.2. Impact on the energy sector	9
2.3. Impact on E.ON.....	10
3. E.ON's response to the new regulatory environment	12
3.1. The conventional responses	13
3.1.1. Lobbying.....	13
3.1.2. Rebalancing the portfolio	15
3.1.3. Expanding international activities	16
3.1.4. Cost-cutting and deleveraging the balance sheet.....	17
3.2. A radical move	18
4. Concluding remarks.....	20
5. Questions for discussion	21
Annexes.....	24

1. Introduction

In December 2008, the European Parliament adopted the final version of the EU climate and energy package. This package sets three rather ambitious goals which would determine relevant changes for energy markets: 1) 20% reduction of greenhouse gas emissions, 2) 20% increase in energy efficiency and 3) 20% increase in renewables consumption by 2020. Targets set at EU level had to be matched by national targets, with national governments often increasing subsidies for renewables such as wind and solar power. These policy changes, together with other relevant extra-European policy and technological changes brought about a deep transformation in the European and global energy markets⁴. Against this backdrop, most of the largest energy producers in Europe, faced major financial losses and their business and corporate strategies were questioned.

This business case outlines the strategic response of E.ON, one of the largest European utility companies, to the changing environment and illustrates how the corporate strategy adapted to the new European policy and regulatory environment. To withstand all the turbulences, the company's management first decided to opt for strong but somehow conventional measures such as i) lobbying the national governments and the European Institutions, ii) increasing investment in renewables, iii) expanding to more attractive emerging markets and iv) implementing cost-cutting measures. This set of actions was intended to help the company keep its competitive positions in the EU; but E.ON decided shortly after to go one step further and split the company business in two parts: one continuing with the conventional business model and one focusing on disruptive technologies.

The paper is structured as follows: the remaining of Section 1 introduces E.ON in the context of the European energy market; Section 2 presents the relevant EU policy changes and their impact on the industry and on E.ON. In Section 3, we outline the company response to the new policy and industry environment, first by highlighting the more conventional measures, followed by the more radical ones. In Section 4 and 5, we

⁴ On top of the new EU policy framework, also the Chinese policy change towards subsidies for photovoltaic generation and the progress made in the USA on batteries' capacity are also to be considered key game changer for energy producers.

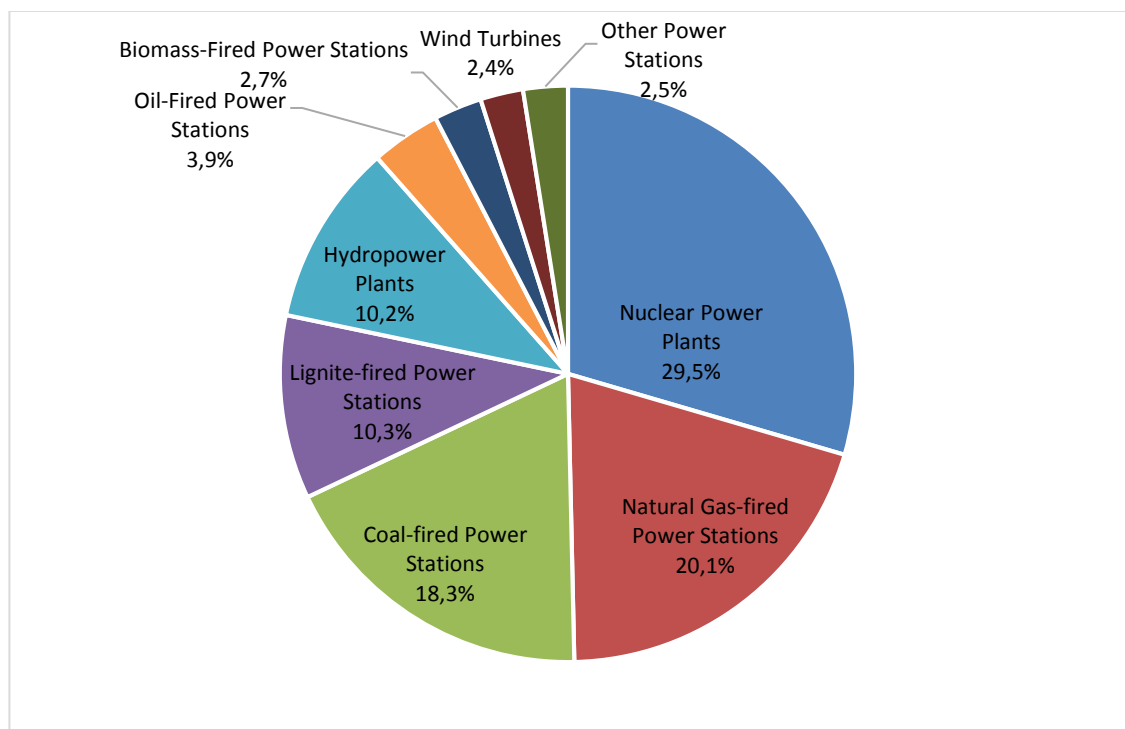
present our concluding remarks and a set of questions which can help class debates and reflective learning.

1.1. The power sector in the EU and E.ON

The EU power sector had been dominated for decades by a few national or regional electricity utilities, in particular by the “big five”: EDF, GDF-Suez (both France), E.ON, RWE (both Germany) and ENEL (Italy).

These companies relied on conventional sources of energy (mainly coal, natural gas and nuclear) to generate electricity.

Figure 1 – Power production in the EU in 2007, by energy source



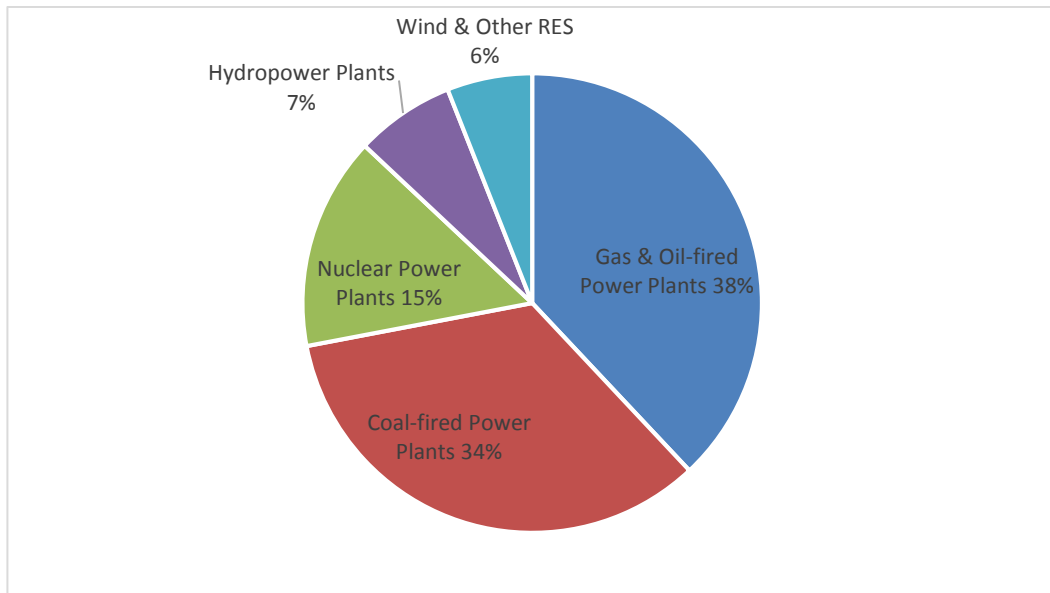
Source: Eurostat (2012)

E.ON was one of the world's largest investor-owned electric utility. In both 2007 and 2008, E.ON was ranked the second electric utility globally in terms of financial performance⁵. Its business model was to operate along the entire energy value chain: generation and production of gas and electricity, transmission, trading, distribution and retail sales. It was thus a major player on the market.

⁵ Platts Annual Survey, [Global Energy Company Rankings](#), which measures companies' financial performance using four metrics: asset worth, revenues, profits, and return on invested capital.

One third of its power generation capacity was located in Germany, the rest being located mainly in other EU countries (the UK, the Nordic countries and Central Europe).⁶ According to the 2009 Company Report, as reported in Figure 2, at end of 2009, E.ON power plants ran mainly on nuclear fuel, gas and coal.⁷

Figure 2 – E.ON Energy capacity in 2009, by energy source



Source: Company Report (2009)

2. The EU energy and climate package and its impact

2.1. Policy objectives and instruments

The beginning of 2007 marked a major change in the EU's energy and climate ambitions. The Commission's proposal for the coordinated changes in the energy sphere was backed by the European Parliament and supported by the Member States at the European Council. This led to the adoption in December 2008 of the EU 2020 Climate and Energy Package, which consists of a set of binding legislations necessary to meet the following targets: 1) a 20% reduction in greenhouse gas (GHG) emissions below the 1990 levels or a 30% reduction if the similar international agreements are achieved; 2) a 20%

⁶ E.ON Annual Report (2010), p. 13.

⁷ E.ON Annual Report (2009), p.11.

increase of the renewable energy share in the total energy consumption; 3) a 20% reduction in energy consumption – improvement in the EU's energy efficiency.⁸

It was the biggest step made by EU institutions to switch to a low carbon and greener economy. Since then, promoting low carbon technology has been increasingly prioritised and has become one of the main EU priorities and a key objective for the coming decades.

On January 22, 2014 the European Commission presented the new framework for Energy and Climate to update emission targets until 2030. The new main targets were a reduction in GHG emissions by 40% below the 1990 level (instead of the 20 % of the 2020 package), an EU single binding target for the share of the renewables consumption of 27% minimum, as well as renewed ambitions for energy efficiency policies, a new governance system and a set of new indicators to ensure a competitive and secure energy system⁹.

Fuels consumed for power generation cause most of GHG emissions, more than emissions caused by the transportation sector or deforestation and agriculture.¹⁰ Despite the difficulty to precisely evaluate the distribution of emissions between sectors, experts agree that the power sector has, for the EU, the biggest potential for cutting emissions.¹¹

Decarbonising the supply side means diminishing the power generation share of carbon-emitting technologies (coal and gas power plants mainly) and increasing the share of low-carbon ones, in particular renewable energy sources.

A key instrument to reduce GHG emissions was supposed to be the EU Emissions Trading System (ETS), which covered more than 40% of the region's emissions, mainly power plants and factories.

In addition to the EU ETS, the European Commission pushed for accelerating the transition to renewable sources. According to the at-the-time EU Energy Commissioner

⁸ European Commission (2008), [Climate change: Commission welcomes final adoption of Europe's climate and energy package](#), press release IP-08-1998.

⁹ European Commission (2014), [2030 Climate and Energy Goals for a Competitive, Secure and Low-Carbon EU Economy](#), press release IP-14-54.

¹⁰ IPCC (2007), [Climate Change 2007 Synthesis Report](#).

¹¹ See for instance H. Weight, E. Delarue and D. Ellerman (2012), [CO2 Abatement from Renewable Energy Injections in the German Electricity Sector: Does a CO2 Price Help?](#), TME Working Paper.

Günther Oettinger “renewables are a solution to global climate change, European economic growth, and security of supply issues”¹². Member states adopted supporting schemes for renewables to comply with the Energy and Climate Package. The 2009 Renewable Energy Directive in particular set specific country-by-country targets ranging from 10% to 49%¹³ (see Annex 1). These support schemes have a different modus operandi, but all-in-all most measures consisted in various forms of public subsidies to renewable generation. For Germany in particular, where about a third of E.ON generating capacity is located, the new European policy framework was strongly supported by the federal government. In 2010, Germany legislated several measures for the *Energiewende* (energy transition) and set ambitious national targets: a renewable energy target of 60% and 80–95% GHG reductions by 2050, relative to 1990. The total amount of subsidies for renewables in Germany for the year 2012 was around €20bn and peaked at about €24bn in 2014.

An additional tool employed to boost renewable energy production at the European level was the “grid priority”. Transmission and distribution system operators are faced with the legal requirement of taking electricity from renewables first.

2.2. Impact on the energy sector

The years 2008 to 2014 were very challenging for the EU energy sector. On top of the global financial crisis, which induced a significant decrease of the energy demand and therefore a reduction of electricity prices, energy producers had to face a changing regulatory environment and the transformation of the energy value chain. The planned functioning and implementation of the 2020 Energy and Climate Package and the 2009 Renewable Energy Directive negatively affected the cost-effectiveness of existing conventional fossil fuel power plants and thus the profits of electric utilities.

Notwithstanding the specificities of support schemes to renewables across Europe, they had one main outcome: a massive increase in generation from renewables,

¹² European Commission (2013), [Renewable Energy: Commission refers Austria to Court for failing to transpose EU rules](#), press release IP-13-1113.

¹³ European Commission, [Directive 2009/28/EC on the promotion of the use of energy from renewable sources](#), published on 23 April 2009.

which originated an over-generation of electricity and thus induced a drop in wholesale prices.

The presence of non-market-based support to renewable production contributed to widening the gap between wholesale electricity prices and power costs; the gap proved to be wide enough to squeeze some highly efficient gas power plants out of the market in favour of solar and photovoltaic generation of electricity.

As the marginal cost of wind and solar power approaches zero, economically speaking, it is rather intuitive to give access to the grid to renewables first. Nevertheless, given that solar and wind power are intermittent, the supply of energy from renewable is volatile and difficult to predict. Nuclear or fuel-fired power plants cannot easily reduce their production to respond to a peak of supply from renewables and are not profitable unless they work on large scale.

Besides its impact on wholesale prices and therefore on the profitability of different energy portfolios, the EU push for renewables also accelerated a transformation of the market structure. In fact, the European energy market, and the German one in particular, started transforming from an oligopoly of few suppliers into a splintered market in which a potentially endless set of small players also generate power, thanks to subsidised and new technologies. That constitutes not only a difficult conjuncture but rather a challenge to the established business model of utilities.

2.3. Impact on E.ON

As mentioned, in 2009 E.ON's energy production relied primarily on nuclear, gas, and coal, with only 13% of its production from renewable resources, i.e. hydro, wind and solar. The company was therefore in a position where subsidies to renewable energy could not offset the losses from conventional power generation.

In line with the impact undergone by the whole industry, the main negative effects that E.ON had to face in the aftermath of the implementation of the new European energy and climate policy framework were a substantial profit and market value loss. The loss was primarily due to:

- A contraction of the output from conventional power plants, which became necessary to contrast the oversupply caused by national

regulations giving preferential access to the networks to renewable energy generated power;

- A marked drop of wholesale prices for electricity. For the core E.ON market, i.e. Germany, electricity prices fell from over €80 per megawatt hour (MWh) at peak hours to about €38 per MWh in 2013. As reported by The Economist (2013), the wholesale price of electricity even fell to minus €100 per MWh in mid-June 2013.
- A significant fall in the value of its power generation assets, as a consequence of the previous two points. In September 2015, the company reported its biggest annual loss, as a result of writing down the value of its coal- and gas-fired power plants by approximately €8.8bn.¹⁴

Overall, E.ON's income from conventional power generation, i.e. fossil fuels and nuclear, fell by more than a third from 2010 to 2013.¹⁵

E.ON's sales and underlying net income respectively decreased in 2013 by 7% and 46% in comparison to 2012 - see Annex 2). The company passed from an annual record loss to another; €3.2bn loss in 2014 and €7.25bn for the year 2015.¹⁶

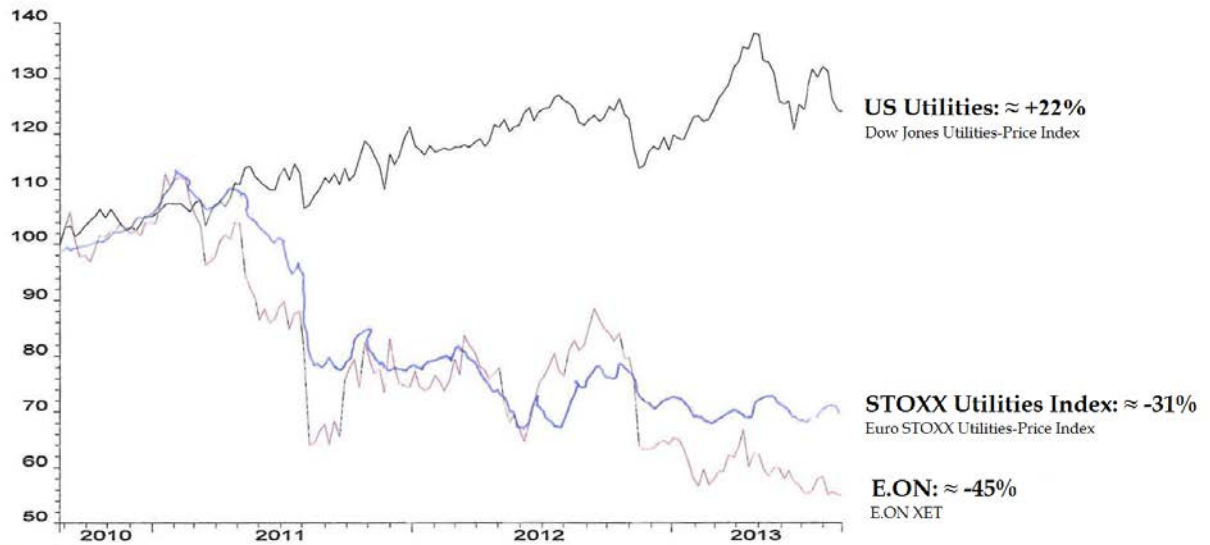
The impact on E.ON's capitalisation was remarkable. As shown in Figure 3, after 2009, the entire industry contracted in Europe (-31%), with respect to US utilities (+22%). An indication that the diminishing stock value was not due to a global trend (i.e. the financial crisis) but rather to a specific EU phenomenon, which can be largely attributed to the new policy framework on energy and climate. E.ON did worse than the Euro STOXX Utilities Index with a noteworthy contraction of 45%.

¹⁴ Financial Times (2015), [Eon reports record loss of €7.25bn as it writes down power assets](#), by Guy Chazan, 11 November 2015.

¹⁵ See The Economist (2013), [How to lose half a trillion euros – Europe's electricity providers face an existential threat](#), 12 October 2013.

¹⁶ Financial Times (2015): [Eon reports record loss of €7.25bn as it writes down power assets](#), by Guy Chazan, 11 November 2015.

Figure 3 – Total Shareholder Return: U.S., EU and E.ON, 2010-2013



Source: Thompson Reuters Datastream and E.ON Presentation, Case study Germany: Failures of the current market design, 2015.

In presenting the results of the financial year 2013, the E.ON's CEO Johannes Teyssen pointed out that the company's "results clearly reflect the negative effects of a difficult economic and regulatory environment in Europe"¹⁷.

3. E.ON's response to the new regulatory environment

"We know where we are. Do we also know where we're going?"¹⁸

To cope with the challenges created by the new regulatory environment and to put a remedy to losses, the E.ON management first implemented some conventional measures: lobbying the national governments and the European Commission, increasing investment in renewables, expanding to the more attractive emerging markets and cost-cutting. Successively, partly because such measures proved to be insufficient to redress financial prospects and partly because it realised that the structure of the energy

¹⁷ E.ON (2014), [E.ON stays on course in difficult environment](#).

¹⁸ E.ON Annual report (2009), p.40.

business was changed for good, E.ON's management decided to introduce more drastic measures. In what follows, we describe this two-step response to the new business environment which emerged from the fast advent of renewables and low wholesale prices for electricity.

3.1. The conventional responses

3.1.1. Lobbying

Electricity utilities have often used their market power to mould the sector and to influence final energy prices and, indirectly, investment decisions. The recent policy outcomes, such as the EU Climate and Energy Package, have watered down this power, and the sector is "increasingly shaped by political decisions".¹⁹

By definition, a changing regulatory environment provides uncertainty for the business sector and companies actively engage with policy-makers in the attempt of minimising the negative impact of upcoming reforms.

During the discussion about the definition of the EU Energy and Climate Package targets energy companies did lobby both at national and at the EU level. What E.ON did was to call for a revision of the multiple target approach, in favour of a single ambitious target. According to the company's CEO "numerous targets are inefficient, contradict each other and are the root cause of inefficiencies. We should go for a climate [emission reduction] target of at least 40% – between 40% and 50% – by 2030 and we should leave it to the markets how to achieve that"²⁰. In clear, E.ON was lobbying against the rollout of massive (and distortive) subsidies to renewables. The company was not in favour of strict renewable energy targets; rather, it looked favourable at a European carbon pricing mechanism – the EU Emissions Trading Scheme – as the main emissions mitigation instrument²¹.

E.ON was very active in the media explaining that it was promoting energy policy reforms. The fact that E.ON's CEO was at the same time President of Eurelectric, the European association of the electricity industry, was clearly advantageous for E.ON.

¹⁹ Łoskot-Strachota A. (2013).

²⁰ Van Renssen S. (2013), Interview with Johannes Teysen, CEO of E.on: "Renewables can become biggest without subsidies", Energy Post.

²¹ To be noticed that the first phase of EU ETS 2005-2008 actually brought profits to large energy producers; profits which have been partly reinvested to expand the generation capacity from conventional sources.

Moreover, E.ON together with nine other major European energy producers (such as the German RWE, the French GDF Suez, the Italian Enel and Eni, and the Spanish Iberdrola Gas Natural, and others) formed the so-called informal Magritte Group to lobby the European Commission²². The Group claimed that the new regulatory environment was threatening security of supply, forcing companies to shut down power plants and causing increases of retail prices for end consumers. On numerous occasions, the Magritte Group stressed that in a European power market already struggling with overcapacity, overly generous subsidies for renewables led to additional waves of investment in solar and wind, further making existing thermal capacity uneconomical to run.

More recently, in early 2014, the Magritte Group drafted a list of nine recommendations on how to improve the EU energy policy. It particularly, it called on the EU to set up a capacity Remuneration Mechanisms (CRM)²³ that would pay utilities for standby capacity and would ensure backup supply.

Whether it be on the EU ETS, renewable energy sources subsidies or CRM, E.ON supported a power shift from member states to the EU level. The favour for enhanced European integration is based on several reasons:

- More centralised power at the EU level could have reduced the uncertainty on the implementation of EU directives. According to E.ON, there is too much flexibility and heterogeneity in the compliance to regulations and directives. Member states had for example the option of replacing a provision with “alternative measures that achieve a comparable effect”²⁴.
- The will to expand their business outside Germany.
- The ambition to «by-pass» the German federal policy-making, which was not favourable to CRM and was keener on pushing for climate and environment targets, than other EU Member State.

E.ON was explaining that the EU and the company's goals went hand in hand and that implemented measures were in line with EU policy objectives: capacity mechanisms for gas-fired power plants were useful to increase security of supply and reach climate

²² Fortum (2014), [CEOs of leading European energy companies' contribution to the European Council](#), 19 March 2014.

²³ Euractiv (2013), [Energy CEOs call for end to renewable subsidies](#), 11 October 2013.

²⁴ E.ON annual report (2013), p.67.

targets, the maintained use of nuclear energy was advantageous to keep on benefiting from competitive energy.

Although well structured, as it involved lobbying at national and EU level from both a corporate and an industry perspective, it is rather difficult to assess the lobbying effort as a successful exercise. Two observations can be made in this respect, which we present the reader in form of questions for debate: i) Could the lobbying strategy have been more successful if the core of lobbying activities had come at an earlier stage, before the Commission's policy proposal?; ii) Was there the possibility to lobby for a more diluted implementation of the push for renewables rather than focusing on pulling out policy targets for renewables?

3.1.2. Rebalancing the portfolio

In addition to its lobbying strategy, E.ON decided to change profoundly its generation portfolio. In 2007, it announced it would double the planned investments in renewable energy sources with respect to what it had envisaged the year before; the new figure being €6 bn through 2010.²⁵ The company set rather ambitious targets. In 2008 wind power represented less than 2% of its generation capacity. The goal was set to 10GW of renewable capacity by 2015, more than five times its 2008 level.²⁶ Building on these ambitious goals, new added capacity amounted to 0.6GW every year from 2008 to 2012. This increase then somewhat surprisingly came to a halt in 2013 and did not resume in 2014.²⁷ Nonetheless, the total added capacity in renewable generation equalled more than 5GW in 2014 as opposed to 2007 levels. The company was able to slow down the profit slump as its wind energy business gathered speed with the rapid build-up of offshore wind capacity in the Baltic Sea. At the end of 2013 renewable energy production accounted for around 12% of the company's earnings²⁸.

E.ON went one step further than just investing in new renewable capacity. The strategy for the reorientation of the energy portfolio was also influenced by the decision of the German Government, in the aftermath of Fukushima accident, to impose a progressive shut-down of nuclear power plants. The company decided to divested many

²⁵ E.ON Annual Report 2007.

²⁶ E.ON Annual Report 2008.

²⁷ E.ON Annual Report 2014.

²⁸ Energy Matters, (2014), [E.ON To Split And Focus On Renewable Energy](#), 2 December 2014.

of its conventional power plants; in only four years, from 2010 to end of 2013, E.ON sold for €20bn of these assets.²⁹ Furthermore, it also froze planned investments. IN 2012, the company abandoned its plans to build new nuclear power stations on the island of Anglesey in Wales and in Oldbury-on-Severn England, a project developed together with its German competitor RWE. Instead, both companies agreed “that investments in renewable energies, decentralised generation and energy efficiency are more attractive”³⁰. The bottom line was a sharp drop in nuclear (-26%) and coal (-47%) capacity.³¹ Until today, E.ON has shut down approximately 15.000MW of old coal power plants. According to the company’s CEO “unless the business environment of the energy industry in the core European markets change[ed] tangibly, other plant closures [would] be unavoidable”³².

3.1.3. Expanding international activities

In view of the challenges that the company faced with the adoption of the EU Energy and Climate Package and the subsequent measures affecting national energy policies in the EU-28, E.ON decided to increase its presence outside the EU market. Lower wholesale prices and the euro area stagnation contributed to a slowdown of growth projections in the European energy sector so that E.ON decided to scale up its subsidiary “E.ON International Energy”. The latter works with local partners “to operate renewable and conventional generating capacity and distribution network and sales businesses outside Europe.”³³ The company decided to expand its activities in Turkey. The country had been one of the fastest-growing economies in the world, as a result of which the rise in its energy demand had been strong and steady. E.ON acquired half of the Turkish company Enerjisa – through a joint venture - under the expectation of increasing E.ON’s share in the Turkish energy market to 10% by 2020³⁴. The energy market in Turkey is more liberalised than the EU internal market, which gives E.ON greater opportunities to develop and bring in profits.

²⁹ E.ON Annual Report 2013.

³⁰ S. Knight (2012), [E.on confirms strategy focused on renewable](#), Windpower Monthly, 30 March 2012.

³¹ Authors’ calculation based on data available in E.ON’s 2008 to 2014 Annual Reports.

³² Bryant C. (2013), [Eon warns of more plant closures as first-half profits fall 42%](#), 13 August 2013.

³³ E.ON Annual Report 2014, p.60.

³⁴ E.ON (2012), [E.ON establishes market position in Turkey](#).

E.ON also expanded its business in one of the biggest energy markets in the world – Russia – by investing in gas-fired plants and creating a joint-venture in western Siberia.

As part of its international expansion program in April 2012 E.ON bought a 11.7% stake in MPX (now Eneva S.A), controlled by the Brazilian Eike Batista, and a year after the two agreed on increasing E.ON's share in the company, up to 36.2%. By signing the agreement with the Brazilian partner and by thus creating the largest energy company in the country, E.ON set foot on Latin America's biggest economy, with a fast-rising demand for energy.

In 2014, non-EU countries nonetheless accounted for only 5% of the company's earnings before interest, taxes, depreciation, and amortisation (EBITDA).

3.1.4. Cost-cutting and deleveraging the balance sheet

In 2011, E.ON's management launched the efficiency program "E.ON 2.0" which aimed at achieving long-term cost reductions and a restructuring of the E.ON Group. The programme entailed cost-cutting measures amounting to approximately €200 million. The company also cut E.ON's employee headcount "from 88,000 in 2009 to 62,000 in 2013 and raised €19 billion in asset disposals"³⁵. There was a large number of disposals, always with the aim to increase liquidity that could be used for growth sectors like renewables and distributed-energy solutions.

As part of the efficiency improving program an organizational transformation of the company was foreseen with a cut in the number of legal entities within E.ON and the establishment of a flatter hierarchy³⁶.

The company reorganised the German regional unit. The new organisation of Exploration & Production and Climate & Renewables also brought significant efficiency gains to the company. Furthermore, E.ON Ruhrgas and E.ON Energy Trading merged into a new branch of the company, E.ON Global Commodities SE (Societas Europaea), which was created in order to unite energy trading and gas activities. Such new entity would be in charge of taking centralized control over the global market trading operations (trading all sorts of commodities: gas, oil, electricity, etc.); a step towards internal integration that

³⁵ Barber T. (2014), Eon feels the heat of German and EU energy policies, Financial Times, 23 January 2014.

³⁶ E.ON Annual Report 2013.

would ideally lead to the optimization of E.ON's portfolio. This measure was supposed to help the company transform from a conventional European utility company into a global client-oriented energy solutions developer.

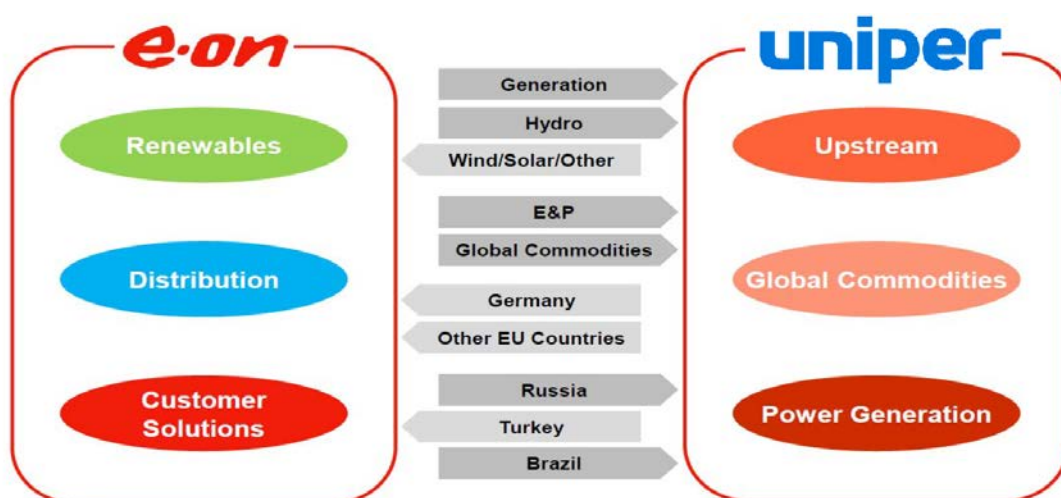
After all these efforts, financial results remained disappointing and growth prospects depressed. In short, could we say that these measures were necessary but not sufficient?

3.2. A radical move

Most utilities at first adopted the option to lay low and wait for the “renewables storm” to blow over. As the public sector push for renewables helped renewable technology to reach maturity and led to an enduring market reorientation, such utilities have consequently paid the price of their dullness.

Faced with diminishing returns and capitalisation, once it was clear that some of the changes promoted by the new European and EU national legislation were there to stay, the E.ON group decided to go one step further. It announced on November 30th 2014 that it would break itself up in two clear-cut parts. The first company would retain the brand name “E.ON” and would target all the disruptive markets: electricity from renewable energy sources, electricity storage, smart grids and digitalisation. A second company, later named “Uniper”, would retain the conventional upstream activities and energy trading.

Figure 4. Two new companies. Source: E.ON Strategy Chart



Source: E.ON (2014), Empowering Customers. Shaping Markets, Press Conference Presentation, 1 December 2014.

In short, two smaller companies with their specific business model would replace, in 2016, the fully integrated mastodon. Acknowledged the changes in the value chain and the new energy business environment, E.ON considered that flexibility would be a strength. Each company would enjoy a better position to seize strategic opportunities and create value in its respective market. Particularly, the new E.ON would be able to redesign its structure and mission to be more responsive to the emerging characteristics of the energy business brought by the growth of renewables: customer proximity and interconnectivity.

Employees, from assembly-line workers to board managers and even the CEO would have, according to the spin-off rationale, a clearer picture of their goal. To give an example of the situation as it was standing, the E.ON CEO, when flying to Brussels or Berlin to discuss with the policy-makers, had to address jointly nuclear decommissioning, the rescue of gas power plants and the renewables deployment targets.

According to the split decision, on one side employees in the conventional generation business would focus on reducing operational costs and providing regular supply, i.e. contribute to security of supply and competitiveness. They would focus on global commodities and manage over 51 GW of power generation capacity in Germany, the UK, Sweden and Russia in order to become a European leader in power and gas.

On the other side, the new E.ON team would come up with innovative solutions in order to improve its position in the wind and photovoltaic sectors, develop on-site generation, design energy-efficient systems for smart cities and become a leading provider of customers solutions.

Figure 5, which builds on E.ON (2014), shows the characteristics of the new and conventional energy worlds, which the two companies are supposed to intercept and develop.

Among the other alternatives that E.ON could have explored, divesting was probably the simpler. The group could have continued divesting at forced speed or could have sold conventional and/or less profitable activities at a slower pace. However, in the second situation, E.ON would then have faced the risk of the “dying-house construction”: employees would have no incentive to work and would ultimately leave the company.

Figure 5 – Conventional and New Energy Businesses

Conventional Energy Business

- Systemic and Centralised Approach with Regional or Global Perspectives
- Focus on the Security of Supply
- Conventional Fossil and Nuclear Technologies
- Large Scale Operations

New Energy Business

- Customer-centric Approach with a Local Perspective
- Focus on Energy Sustainability
- Clean Technologies and Digital Applications
- Small Scale Solutions and Small Network

As a whole, the spin-off and breakout seemed to be for the company a daring option, but somewhat unavoidable. Several points, which are out of the scope of this business case, still have to be clarified: Was the separation and division of business portfolios managed correctly? Could the new business model be reimagined differently? Would these two new entities have to compete? What is the corporate strategy that each one should now follow?

4. Concluding remarks

The EU energy industry has been facing profound and far-reaching changes with the introduction of the 2020 and then 2030 EU Climate and Energy Packages and implementing measures. The rapid switch to renewables as one of the up-and-coming pillars had dramatic effect on energy suppliers which relied on conventional generation and “fossil” power plants. Subsidies to the renewables production led to an oversupply of electricity which compressed the wholesale price. EU intervention matched with efforts at national level, plus technological enhancements, turned the traditional business environment upside down and made the integrated business model unfit for the redesigned energy market. As a result, the conventional utilities faced major financial losses.

E.ON, one of the largest and most powerful players on the European energy market, coped with the changing business environment in two steps. At first, the strategy

involved a set of conventional responses: i) intensification of lobbying at the national and European level, ii) a revision of the energy portfolio by increasing investments in renewable energy production, iii) expansions to non-European markets with the company's international branch expanding its activities into more attractive emerging markets and, last but not least, iv) a far-ranging cost-cutting programme.

In a second phase, E.ON management recognised the need to develop a new business model and decided to change the 100 year-old integrated model.

With a bold move in 2014, E.ON split the company into two. Whilst it remains to be seen whether this decision would lead to positive outcomes for the company(ies), it is rather certain that by dividing the large E.ON portfolio of businesses in two more-specialised companies, E.ON can at least glance at growth prospects anew.

5. Questions for discussion

1. What kind of changes was E.ON confronted with?
2. What did the company's management do to respond to the new environment?
3. Has E.ON been wise by being radical?
4. How do you think could have proceeded with the spin-off?
5. Which other measures could have E.ON taken?

6. References

EU sources

European Commission (2008), [Climate change: Commission welcomes final adoption of Europe's climate and energy package](#).

European Parliament and Council (2009): Directive 2009/28/EC on the promotion of the use of energy from renewable sources, 23 April 2009.

European Commission (2014), [2030 climate and energy goals for a competitive, secure and low-carbon EU economy](#).

Articles

Łoskot-Strachota A. (2013), [Too high and too low: the problems with energy prices in the EU](#), OSW Commentary, n. 122, Centre for Eastern Studies.

Barber T. (2014), [Eon feels the heat of German and EU energy policies](#), Financial Times, 23 January 2014.

Bryant C. (2013), [Eon warns of more plant closures as first-half profits fall 42%](#), Financial Times, 13 August 2013.

Capros P., L. Mantzos (2008), [Report to DG ENV: Model-based Analysis of the 2008 EU Policy Package on Climate Change and Renewables](#).

Deutsche Welle (2013), [German renewables drive hits E.on profits](#), 13 November 2013.

Energy Matters (2014), [E.ON To Split And Focus On Renewable Energy](#), 2 December 2014.

Euractiv (2013), [Energy CEOs call for end to renewable subsidies](#), 11 October 2013.

Financial Times (2015), [Eon reports record loss of €7.25bn as it writes down power assets](#), 11 November 2015.

Fortum (2014), [CEOs of leading European energy companies' contribution to the European Council](#), 19 March 2014.

Knight S. (2012), [E.on confirms strategy focused on renewable](#), Windpower Monthly, 30 March 2012.

Van Renssen S. (2013), Interview with Johannes Teyssen, CEO of Eon: [Renewables can become biggest without subsidies](#), Energy Post. 3 December 2013.

The Economist (2013), [How to lose half a trillion euros](#), 12 October 2013.

Weight H., E. Delarue and D. Ellerman (2012), [CO2 Abatement from Renewable Energy Injections in the German Electricity Sector: Does a CO2 Price Help?](#)”, TME Working Paper.

E.ON sources

E.ON (2008), [Annual Report 2007](#).

E.ON (2009), [Annual Report 2008](#).

E.ON, [E.ON establishes market position in Turkey](#), 12 April 2012.

E.ON, [E.ON stays on course in difficult environment](#), 13 November 2013.

E.ON (2014), [Annual Report 2013](#).

E.ON, [Empowering Customers. Shaping Markets](#), Press Conference Presentation, 1 December 2014.

E.ON (2015), [Annual report 2014](#).

Annexes

Annex 1 – Targets by Member States proposed by the EC for 2020

Obligations for 2020		Non-EU ETS target	RES target
Austria	AT	-16%	34%
Belgium	BE	-15%	13%
Bulgaria	BG	20%	16%
Cyprus	CY	-5%	13%
Czech Republic	CZ	9%	13%
Denmark	DK	-20%	30%
Estonia	EE	11%	25%
Finland	FI	-16%	38%
France	FR	-14%	23%
Germany	DE	-14%	18%
Greece	EL	-4%	18%
Hungary	HU	10%	13%
Ireland	IE	-20%	16%
Italy	IT	-13%	17%
Latvia	LV	17%	42%
Lithuania	LT	15%	23%
Luxembourg	LU	-20%	11%
Malta	MT	5%	10%
Netherlands	NL	-16%	14%
Poland	PL	14%	15%
Portugal	PT	1%	31%
Romania	RO	19%	24%
Slovakia	SK	13%	14%
Slovenia	SI	4%	25%
Spain	ES	-10%	20%
Sweden	SE	-17%	49%
United Kingdom	UK	-16%	15%

Source: Report to DG ENV: Model-based Analysis of the 2008 EU Policy Package on Climate Change and Renewables

Annex 2 – E.ON Group Financial Highlights for 2012 and 2013

	2013		2012		+/- %
Electricity sales	704.4	billion kWh	740.9	billion kWh	-5
Gas sales	1,091.7	billion kWh	1,162.1	billion kWh	-6
Sales	122,450	million EUR	132,093	million EUR	-7
EBITDA ¹	9,315	million EUR	10,771	million EUR	-14
EBIT ¹	5,681	million EUR	7,012	million EUR	-19
Net income	2,510	million EUR	2,613	million EUR	-4
Net income attributable to shareholders of E.ON SE	2,142	million EUR	2,189	million EUR	-2
Underlying net income ¹	2,243	million EUR	4,170	million EUR	-46
Investments	8,086	million EUR	6,997	million EUR	+16
Cash provided by operating activities of continuing operations	6,375	million EUR	8,808	million EUR	-28
Economic net debt (at year-end)	31,991	million EUR	35,845	million EUR	-11
Employees (at year-end)	62,239		72,083		-14
Earnings per share attributable to shareholders of E.ON SE ²	1.12	EUR	1.15	EUR	-3
¹ Adjusted for extraordinary effects. ² Based on shares outstanding.					

Source: E.ON Annual Report, 2013.