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European energy mergers: part of the problem or the solution?

The drive by the European Commission towards a single, competitive, European energy market is being accompanied by a wave of mergers in this sector. The competition-based merger control framework makes pan-European deals easier to complete than the creation of 'national champions'. However, the framework also limits the scope of regulators to use merger control as a policy tool for pursuing their wider sector goals

With little over six months remaining until the European Commission's deadline for the full liberalisation of energy markets in Europe, there has been a noticeable spate of mergers and acquisitions (M&A) activity in Europe. The Commissioners for Competition and Energy, Neelie Kroes and Andris Piebalgs respectively, are taking action on a number of fronts in their drive towards the creation of a competitive pan-European energy market. This includes the sector inquiry, specific action under competition law, and an assessment of compliance with the electricity and gas liberalisation Directives.

The scale of the challenge was highlighted in a Commission press release in relation to the E.ON/Endesa merger, which stated that 'the markets [are] still predominantly national in scope'.[1] In her speech in Lisbon on October 30th, Kroes stated that a single market for energy did not exist in Europe and that the ongoing sector inquiry had identified significant problems. Of note was the fact that there is little cross-border integration, a lack of liquidity, vertical integration that is the source of systemic conflicts of interest, and too much (national) market concentration.[2]

This regulatory action is taking place alongside a number of mergers in the sector, raising the question of the extent to which the merger control framework can be used as an additional policy tool in the drive for liberalisation. The recent merger activity can be broadly characterised in two categories: those mergers portrayed as creating 'national champions' through consolidation in domestic markets, either within the electricity sector or through electricity/gas mergers; and cross-border mergers seeking to create pan-European energy

Table 1 Selected energy sector mergers and acquisitions

Acquirer	Target company	Deal status	Investigating authority	Year
Cross-fuel deals				
Suez (French)	GDF (French)	Pending	European Commission	2006
DONG (Danish)	Elsam (Danish)	Completed	European Commission	2006
Gas Natural (Spanish)	Endesa (Spanish)	Pending (see E.ON bid)	Comisión Nacional de Energía (CNE)	2005
EDP/ENI (Portuguese/Italian)	GDP (Portuguese)	Blocked	European Commission	2004
E.ON (German)	Ruhrgas (German)	Completed	Blocked by Bundeskartellamt. Approved by the Ministry of Economics	2002
Pan-European deals				
Iberdrola (Spanish)	ScottishPower (UK)	Pending	European Commission	2006
E.ON (German)	Endesa (Spanish)	Pending (see Gas Natural bid)	European Commission (although also investigated by CNE)	2006
E.ON (German)	Powergen (UK)	Completed	European Commission	2002
RWE (German)	Innogy (UK)	Completed	European Commission	2002
EDF (French)	EnBW (German)	Completed	European Commission	2001

Note: This list is not exhaustive.
Source: Oxera.

companies. Table 1 above presents a sample of recent mergers, attempted as well as realised.

Both types of merger could be seen as a response to regulatory pressure. A focus on excessive market concentration within a particular national electricity or gas market (see the sector inquiry's preliminary report[3]) means that if a company wants to grow it needs to move either into a different fuel or across borders. The commercial rationale also depends to some extent on the success of the regulators in pushing for a pan-European energy market. Greater integration of gas and electricity markets increases the value of having a significant presence in both markets, while moves towards cross-border trading would make it more likely that there will be operational and strategic synergies between businesses in Spain and the UK (for example).

In general, it has been easier to secure regulatory consent from the Commission for cross-border deals than for (largely) domestic cross-fuel deals. This article looks at how the authorities have responded to the various mergers, with a focus on the European Commission, and puts this in the context of the wider Commission activism in energy regulation.

National champions?

There have been several examples that highlight where governments have appeared to favour domestic takeovers. This is despite the fact that the Commission has pressed national governments hard to remove inappropriate barriers to acquisitions by foreign companies through imposing regulations and conditions on the parties to the merger. The Commission has also fought against the use of measures such as 'poison pill' defences and government holdings of golden shares. Charlie McCreevy, the Internal Market Commissioner, is reported to have written to the German authorities asking them to give up their special rights in E.ON/Ruhrgas.[4] These special rights could be used, for example, to oblige a divestment of Ruhrgas should E.ON be acquired by a (non-German) enterprise.

The Suez/GDF merger is said by some commentators to have pre-empted a takeover bid by Enel, an Italian energy firm.[5] The preference for a 'national champion' appears to have been revealed by the Spanish authorities, when regulatory conditions were proposed relating to the possible takeover of Endesa by E.ON, even though the Commission had already approved it under its jurisdiction (see below for more details).

Cross-fuel mergers have had a mixed reception by regulators. For example, the acquisition in 2004 of GDP, the incumbent gas operator in Portugal, by EDP, a Portuguese electricity operator, and ENI, an Italian energy operator, was blocked by the Commission on the grounds that, although ENI was involved as an acquiring party, there would be competitive harm in both industries. The Commission believed that 'the deal would have impeded effective competition' and 'the concentration would […] significantly reduce or pre-empt the effects of liberalisation of the electricity and gas markets, and increase prices for domestic and industrial customers'.[6]

Another interesting case is the E.ON/Ruhrgas merger in Germany in 2002. Although the transaction was blocked initially by the Federal Cartel Office, the Bundeskartellamt, the companies successfully applied to the Ministry of Economics for Ministerial Authorisation to overrule the Bundeskartellamt's decisions prohibiting the direct and indirect acquisition of Ruhrgas.[7]

While the merger control framework takes into account impacts on competition, energy security has been cited by some as a benefit of cross-fuel mergers. For example, Dominique de Villepin, the French Prime Minister, defended the Suez/GDF merger in a speech at the Bertelsmann Foundation where he argued that this transaction would aid European energy independence.[8] However, how his suggestion that 'we should not simply suffer the mechanical interplay of supply and demand' would be reconciled with the move towards market-based pricing is unclear.

Towards a single unified market

Difficulties of securing regulatory approval for deals involving local consolidation are one reason to look at cross-border deals. While a single unified market for energy in Europe may still be a long way off, liberalisation has provided both the opportunities and the incentives for energy companies to develop pan-European positions. Although not always welcomed by governments of the target company's country, the Commission has largely taken the view that these deals are helpful in the process of moving towards a pan-European market.

The Commission's positive attitude to cross-border deals was illustrated in the treatment of the merger between EDF of France and EnBW of Germany. Although conditions were attached by the Commission to this merger, the Commission was ready to point out that 'the transaction would […] significantly contribute to EdF's outstanding position as a pan-European supplier'.[9]

A recent example of conflict between the Commission and national regulators over this issue is the proposed E.ON/Endesa merger approved by the Commission. Of note is the fact that the CNE, the Spanish National Energy Commission, issued its own 'approval' of the merger with several conditions attached under powers introduced by the Spanish government three days after E.ON's bid was launched. While certain measures can be adopted by national regulatory authorities (NRAs) to ensure that they can regulate effectively, the measures imposed by the CNE included, for example, the divestment of 30% of generation assets. In response the Commission has begun formal infringement proceedings against Spain for impinging on the Commission's exclusive jurisdiction, and legal proceedings are being pursued.

Even in the UK energy market, which is often cited as a model for liberalised markets, considerations other than the pure incremental impacts on competition from the proposed merger have been raised in the context of foreign acquisitions.

In January 1999 the UK authorities requested of the European Commission that EDF's acquisition of London Electricity be referred to the UK Secretary of State for Trade and Industry and the Director-General of Electricity Supply. The reason for this request was that significant political concerns were raised by this merger, in particular due to the lack of reciprocity and the inability of British firms to enter the French market. However, this was rejected by the Commssion on the basis that the transaction did not threaten to create or strengthen any dominant position, and it was cleared by the Commission at the Phase I stage.

While this request by the UK might be seen as an attempt to further European liberalisation by raising the issue of reciprocity, security rather than competition issues are sometimes discussed in the context of energy deals. The alleged interest in Centrica by Gazprom is reported to have prompted discussion of energy security grounds as a rationale for regulatory intervention by the Secretary of State for Trade and Industry.[10]

Conclusion

The evidence set out in this article points to the fact that the competition-based merger control framework is pushing companies away from single-fuel domestic market consolidation towards cross-fuel and, increasingly, cross-border deals. The Commission has been ready to enforce its decisions and to promote the ideal of pan-European companies, even if this necessitates proceedings against Member States that have vested national interests. Competition concerns have made it increasingly difficult to expand within domestic borders, although cross-fuel deals have sometimes been successful.

However, merger regulation is only one instrument and will need to be complemented by the use of competition law, Directives and sector inquiries in order to achieve full effective liberalisation. Furthermore, while the role of energy security concerns in merger control has been minimised, the potential conflicts between liberalisation and security are likely to be a key theme in 2007 as competition law and energy Directives are used to push towards the creation of a single European energy market.

[1] European Commission (2006), 'Mergers: Commission Approves Acquisition by E.ON of Endesa', press release, April 25th.
[2] European Commission (2006), 'A New Energy Policy for a New Era', speech by Neelie Kroes, Conference on European Energy Strategy: The Geopolitical Challenges, Lisbon, October 30th.
[3] European Commission (2006), 'Energy Sector Inquiry: Draft Preliminary Report', February 16th.
[4] *Financial Times* (2006), 'Germany Urged to End Eon Golden Share', October 22nd, http://search.ft.com/searchArticle?queryText=golden+share&javascriptEnabled=true&id=061022003390.
[5] *The Economist* (2006), 'French Economic Nationalism: Colbert was Here', May 23rd.
[6] European Commission (2004), 'Mergers: Commission Prohibits Acquisition of GDP by EDP and ENI', press release, December 9th.
[7] Bundeskartellamt (2002), 'Bundeskartellamt Prohibits E.ON/Gelsenberg (Ruhrgas) Merger', January 21st, and Bundeskartellamt (2002), 'Bundeskartellamt Prohibits E.ON's Acquisition of Majority Stake in Ruhrgas', February 28th.
[8] De Villepin, D. (2006), speech addressing Tenth International Bertelsmann Forum, Berlin, September 22nd, http://www.ambafrance-uk.org/Dominique-de-Villepin-addresses.html.
[9] European Commission (2001), 'Mergers: Commission Clears Purchase by EdF of a Stake in German Electricity firm EnBW Subject to Conditions', press release, February 7th.
[10] *Financial Times* (2004), 'Gazprom Prompted Rethink on UK Merger Rules', Eaglesham, J., July 12th, https://registration.ft.com/registration/barrier?referer=http://www.google.co.uk/search?hl=en&q=Financial+Times+Gazprom+Prompted+Rethink+on+UK+Merger+Rules&meta=&location=http%3A//news.ft.com/cms/s/ac558d4a-cd7c-11da-afcd-0000779e2340.html.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email d_holt@oxera.com

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