

*This text is made available for information purposes only.
A summary of this decision is published in all Community languages in the Official Journal
of the European Union*

Case No
COMP/M.3440
ENI / EDP / GDP

Only the English text is authentic.

REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 8 (3)

Date: 09/12/2004



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 9.12.2004
C(2004)4715 final

PUBLIC VERSION

COMMISSION DECISION

of 9.12.2004

declaring a concentration to be incompatible with the common market

(Case No COMP/M.3440 – EDP/ENI/GDP)

(Only the English text is authentic)

COMMISSION DECISION

of 9.12.2004

declaring a concentration to be incompatible with the common market

(Case No COMP/M.3440 – EDP/ENI/GDP)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Agreement on the European Economic Area, and in particular Article 57 thereof,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings¹, and in particular Article 8(3) thereof,

Having regard to the Commission's decision of 12 August 2004 to initiate proceedings in this case,

Having regard to the opinion of the Advisory Committee on Concentrations²,

Having regard to the final report of the Hearing Officer in this case³,

WHEREAS:

1. On 9 July 2004, the Commission received a notification of a proposed concentration pursuant to Article 4 of Regulation (EEC) No 4064/89 (“the Merger Regulation”), whereby Energias de Portugal SA⁴ (“EDP”) and Eni Spa, through its wholly-owned subsidiary Eni Portugal Investment S.p.A, (“Eni”) acquire within the meaning of Article 3(1)(b) of the Merger Regulation joint control over Gás de Portugal SGPS S.A (“GDP”), by way of purchase of shares.
2. On 12 August 2004, having examined the notification, the Commission concluded that the notified operation fell within the scope of the Merger Regulation and that it raised serious doubts as to its compatibility with the common market. The Commission therefore initiated proceedings in accordance with Article 6(1)(c) of the Merger Regulation.
3. Following an in-depth investigation of the case, the Commission takes the view that, despite the commitments given by the notifying parties, the proposed operation will

1 OJ L 395, 30.12.1989, p. 1; corrected version OJ L 257, 21.9.1990, p. 13. Regulation as last amended by Regulation (EC) No 1310/97 (OJ L 180, 9.7.1997, p. 1).

2 OJ C

3 OJ C

4 Formerly Electricidade de Portugal SA.

lead to the strengthening of EDP's and GDP's respective dominant positions on the electricity and gas markets in Portugal, as a result of which effective competition would be significantly impeded in a substantial part of the common market.

4. The Advisory Committee discussed the draft of this Decision on 26 November 2004.

I. THE PARTIES

5. **EDP** is the incumbent electricity company in Portugal. As such, its main activities consist of generation, distribution and supply of electricity in Portugal. EDP also controls the Spanish company Hidrocarburo⁵, which is active in Spain in the sectors of electricity and gas. EDP is listed on the Euronext Lisbon and the Portuguese State holds directly or indirectly about 30% share thereof.
6. **ENI** is an Italian energy company active at all levels of the energy supply and distribution chain.
7. **GDP** is the incumbent gas company in Portugal. GDP is a wholly-owned subsidiary of the Portuguese company Galp Energia, SGPS, S.A. ("GALP"), currently jointly controlled by the Portuguese State⁶ and ENI, with interests in both the oil and the gas sectors. GDP and its subsidiaries cover all levels of the gas chain in Portugal. GDP, through its subsidiary Transgás, imports natural gas into Portugal, through pipelines and through the Sinès LNG terminal, and is responsible for the transportation, storage, transport and supply through the high-pressure gas pipeline network (the "Network"). GDP is also active in the natural gas supply to large industrial customers and in the development and future operation of the first underground natural gas storage caverns in Portugal. GDP, through GDP Distribuição ("GDPD"), also currently controls five of the six local distribution companies active in Portugal.
8. As explained below, Rede Eléctrica Nacional S.A. ("**REN**") is not a notifying party for the present concentration but takes part in the overall transaction to which this concentration belongs. REN is a Portuguese company resulting from the 1994 spin-off from EDP of the Portuguese electric grid. REN currently manages the Portuguese electric grid and acts as Single Buyer, buying electricity from producers and reselling it to the distributor/supplier for the supply of the non-eligible clients. The Portuguese State controls directly or indirectly 70% of REN while the remainder is held by EDP.

II. THE OPERATION AND THE CONCENTRATION

9. The present operation concerns the acquisition of joint control over GDP by EDP and ENI. Pursuant to the share purchase agreements concluded on 31.03.2004 between the parties, the transaction is structured in two subsequent phases. In the first phase of transaction, EDP, ENI and REN jointly acquire the whole of GDP's share capital from

⁵ Currently, EDP has joint control over Hidrocarburo with a 40% share (see Case COMP/M.2684-EnBW/EDP/Cajastur/Hidrocarburo). On 05.08. 2004, EDP notified to the Commission the acquisition of sole control over this company. The Commission approved this operation on 9 September 2004..

⁶ The Portuguese State holds directly 30% and indirectly 18.3% of GALP. ENI holds 33.34%. The remainder is mainly owned by EDP (14.3%).

GALP⁷. The second phase of the transaction will take place no later than [...] months and [...] days after the first phase and will consist in the spin-off from GDP and the subsequent transfer to REN of the Network and, possibly, of [...] in exchange of REN's shareholding in GDP.

10. Considering the purely transitional nature of the first phase of the transaction, its relatively short time frame and the clear break up situation which will result after the second phase, the Commission considers that this complex transaction leads to two distinct concentrations within the meaning of the Merger Regulation: (i) the acquisition by EDP and ENI of joint control over GDP⁹ and (ii) the acquisition by REN of sole control over the Network.
11. As all binding agreements defining these transactions have been signed by the parties on 31 March 2004, Council Regulation (EEC) No 4064/89 applies to the notified operation.

III. COMMUNITY DIMENSION

12. The undertakings concerned in the acquisition by EDP and ENI of joint control over GDP have a combined aggregate world-wide turnover of more than EUR 5 billion¹⁰. Each of the undertakings concerned has a Community-wide turnover in excess of EUR 250 million, but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State.
13. The notified operation therefore has a Community dimension¹¹.

IV. RELEVANT MARKETS

A. Relevant markets in the energy sector

14. The market investigation has confirmed the approach taken in past Commission decisions¹² as regards a separation of energy markets by type of energy. In particular, the market investigation has shown that natural gas and electricity do not belong to the

⁷ ENI was so far already jointly controlling GALP, along with the Portuguese State, and thus indirectly GDP.

* Parts of this text have been edited to ensure that confidential information is not disclosed; those parts are enclosed in square brackets and marked with an asterisk.

⁸ [...]

⁹ EDP will thereby hold 51% of the shares and ENI will hold 49% of the shares. Each of the parties will have important control rights amounting to a situation of joint control.

¹⁰ Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C 66, 2.3.1998, p. 25). To the extent that figures include turnover for the period before 1.1.1999, they are calculated on the basis of average ECU exchange rates and translated into EUR on a one-for-one basis.

¹¹ By contrast, the acquisition by REN of sole control over the Network is not of Community dimension and, accordingly, has been notified to the Portuguese Competition Authority on 17.6.2004.

¹² All past Commission's decisions which have come to a conclusion as regards product market definitions in the energy sector have considered gas and electricity market separately.

same product market. The overwhelming majority of customers has stated that they would not consider switching from gas to electricity or vice versa in case of even a significant relative price increase of one of the two forms of energy. The reasons indicated were mainly the high switching costs between the two form of energy necessitating considerable investments in applications geared to processing one form of energy or the other.

15. While gas and electricity thus constitute distinct product markets, the market investigation, as explained below in greater detail, confirmed that being able to offer customers both electricity and gas (so-called “dual offers”) confers a competitive advantage.
16. The following analysis will deal first with electricity market definition and, secondly, natural gas market definition. According to previous Commission decisions, the definition of the relevant product market(s) must take into account the existing and foreseen degree of opening thereof¹³. Each chapter will therefore commence with a consideration of the state of the opening process of the electricity and natural gas markets in Portugal.

B. The relevant electricity markets

1. Regulatory framework

(a) Current legal framework

17. The main legislation governing the Portuguese “National Electric System” (*Sistema Eléctrico Nacional* - “SEN”) was passed in 1995 through a set of decree-laws¹⁴. The National Electric System is organised in two co-existing systems, the public electricity system or “bound system” (*Sistema Eléctrico de Serviço Público*, “SEP”) and the independent electricity system (*Sistema Eléctrico Independente*, “SEI”). The national transmission grid is used for both systems and is exploited under a concession regime by Rede Eléctrica Nacional (“REN”).
18. SEP is a regulated system that covers generation and distribution. It is composed of “bound” generators and “bound” distribution networks.
19. In this system, REN is the single buyer of electricity at the wholesale level. It mainly acquires electricity from a group of power stations (the “bound generators”), pursuant to Power Purchase Agreements (“PPAs”).
20. Under the PPAs, bound generators undertake to supply electricity to the SEP on an exclusive basis for a term of more than 20 years and under a fixed price formula¹⁵. The construction of those bound generation plants is not liberalised but regulated by the State. According to the applicable legislation, the following companies are integrated in the SEP: EDP (through EDP Produção and Companhia Portuguesa de Produção de Electricidade), Tejo Energia¹⁶, and Turbogás¹⁷. Most of the electricity in Portugal (83%

¹³ Case COMP/M. 2684 – EnBW/EDP/Cajastur/Hidrocantabrico: OJ C 114, 15.5.2002, p. 23.

¹⁴ See, in particular Decree-laws 182/95, 184/95, and 185/95 of 27 July 1995.

¹⁵ The price formula essentially guarantees the payment for capacity (which implies a predetermined return on invested capital for the plant) and for energy (based on a reflection of costs).

¹⁶ Tejo Energia is controlled by the British company International Power, which holds 45% of the shares, and by the Spanish company Endesa, with 35% of the shares. EDP and Electricité de France only hold a

in 2003)¹⁸ is supplied through these exclusive PPAs between REN and power producers.

21. The electricity acquired by REN is then sold to the regulated distributor, which is controlled by EDP, under a regulated tariff system. Regulated tariffs are set by the Portuguese energy regulator, ERSE (*Entidade Reguladora do Sector Energético*).
22. The independent system (SEI) is composed of the unbound system (*Sistema Eléctrico Não Vinculado*, “SENV”), which operates under free market conditions (i.e. most of this power is finally sold to the customers who switch out of the regulated system), and the special regime system (*Produtores em regime especial*, PRE), in which generation by co-generation plants, mini-hydro plants, and other renewable energies such as wind power plants is supplied to REN at regulated tariffs
23. Eligible customers are free to choose their electricity supplier and can therefore purchase electricity either from the SEP at regulated tariffs, or from the SENV (being supplied by a free retailer at market conditions). The minimum threshold for customers’ eligibility has been progressively reduced. Until the end of 2003, eligible customers were those connected to the medium, high and very high-voltage grid (voltage level above 1kV) and represented 44.7% of the overall electricity consumption in 2003. In 2004 the number of eligible customers was first enlarged to some low-voltage customers. By 1 July 2004 the degree of opening was therefore around 54 % of consumption. The Decree Law of 17 August 2004 finally provided that all clients are eligible.¹⁹

(b) Amendments to the existing regulatory framework

24. The existing regulatory framework is currently being amended.
25. In 2003²⁰ the Portuguese government established general rules aimed at terminating the PPAs. It is now in the process of renegotiating these agreements with the bound generators, including the award of compensation. Under this regime, so-far bound generators will no longer have to sell their electricity to a single buyer (REN), due to the termination of the PPAs. However, they will be entitled to compensation for the loss of revenue because of the difference between the fixed prices initially provided in the PPAs and the future (actual or expected) market price of electricity. All previously bound generation capacity will then be available on the liberalised wholesale market.
26. On 5 April 2004, the Portuguese Government notified this scheme to the Commission, under the State aid rules established by the EC Treaty, to the extent that it will imply the award of compensations for stranded costs incurred by bound generators. The Commission has since then taken a formal decision approving the proposed scheme²¹.

minority 10% interest each, which does not seem to confer to either of them the possibility to exercise joint control over the company.

¹⁷ At the time of the notification Turbogás was controlled by the German power company RWE. EDP holds a 20% stake, which does not seem to confer to it the possibility to exercise joint control over the company. RWE has since concluded a sales agreement with International Power. International Power’s purchase has been approved by the Portuguese Competition Authority.

¹⁸ 35 TWh out of a total supply of 43 TWh in 2003.

¹⁹ Portugal will thus advance implementation of Directive 2003/54/EC of the European Parliament and the Council (OJ L 176, 15.7.2003, p. 37) which provides the full opening the electricity retail markets as from 1 July 2007.

²⁰ Decree-Law 185/2003 of August 20, 2003.

²¹ Cf Commission decision Aide d’Etat N 161/2004 – Portugal, adopted on 22 September 2004.

27. The above-mentioned legislation also foresees a number of innovations on the organization of the wholesale electricity market: (i) a wholesale organised market, which would receive supply offers from generators and external agents; (ii) regulated retailers and free retailers, which will acquire electricity in the wholesale organised market or directly from generators on the basis of direct agreements; (iii) external agents dedicated to import and export electricity. REN will then abandon its role of exclusive buyer of electricity. These amendments to the current system are not yet implemented as they first require that PPAs are terminated.

(c) *The Iberian electricity market (MIBEL)*

28. The project of a wholesale Iberian electricity market has been under consideration for several years. In 2001, a Collaboration Protocol was signed between the governments of Portugal and Spain, which initially established a start date of January 2003. The latest agreement was entered into by the Spanish and Portuguese authorities in January 2004 and provided that the Iberian electricity market should be implemented as from 20 April 2004. This agreement provides that electricity should be traded in either of the following ways: bilateral contracts between generators, retailers and end-consumers; an organised spot market; a financial derivatives market. Pursuant to this agreement, there should also be a single market operator/manager (the Iberian Market Operator, OMI).
29. The system to be put in place is said to be inspired by the Spanish model, in which wholesale of electricity takes place either throughout the so-called organised wholesale market or throughout the so-called “free market”. In the former, producers and other agents offer electricity to a pool, which is run by two regulatory bodies: the market operator (*Compañía Operadora del Mercado Español* – OMEL) and the system operator (*Red Eléctrica de España* - REE). In the “free market” (or OTC market), bilateral agreements are concluded between free agents, subject to informing OMEL and REE.
30. A new agreement between the Portuguese and the Spanish government has been signed in October 2004, setting a new date for the launch of the MIBEL (30.06.2005). However, as will be explained in detail below, high uncertainties remain as to the actual creation of the MIBEL and its effectiveness given the several postponements so far and the number of important regulatory issues which still have to be agreed upon and harmonised (such as organisation of the market, system operation, market splitting and transmission constraints and others) before the MIBEL can be effective.

2. Electricity product markets

(a) *General*

31. In previous decisions concerning the electricity sector, the Commission has considered that the following product markets should be distinguished:
- (i) generation and wholesale supply of electricity,
 - (ii) transmission,
 - (iii) distribution,
 - (iv) retail supply,

- (v) possibly, the provision of regulating/balancing power services²².
32. The Commission has also distinguished separate product markets as between large (that is, industrial) customers and small (household and small business) customers.²³
33. Taking into consideration the specifics of the Portuguese markets and the competitive/regulatory framework, as will be explained below, the Commission has reached the conclusion that the four above-mentioned markets should indeed be distinguished. As regards the retail supply, the Commission has also found that large industrial customers (high-voltage and medium voltage) constitute a market distinct from the smaller customers (low voltage).

(b) *Transmission and distribution grids*

34. Regarding the operation and management of the high voltage grid (“transmission”) and the lower voltage grid(s) (“distribution”), the Commission has consistently found that these activities constitute natural monopolies and that no competition is taking place on this level. If parties owned distribution networks in different parts of the country it was found that these activities do not overlap as each of these grids constitutes a separate market as, for any given customer, distribution through one distribution grid is not substitutable with distribution through another grid.
35. These markets are not affected by the proposed operation. In Portugal the transmission grid has already been unbundled and is operated by REN, the Portuguese Transmission System Operator. Distribution grids are owned by EDP and municipalities and are managed by EDP’s subsidiary EDP Distribuição Energia SA (“EDPD”). Access to both transmission grid and distribution grids is regulated by the Portuguese regulator ERSE.
36. Apart from access, which is regulated, another important issue concerning the grid which affects competition in electricity supply markets is the available capacity of this grid, particularly the interconnection capacity between neighbouring countries, in this case between Portugal and Spain.

(c) *Wholesale of electricity*

37. The parties agree that, for the purpose of the assessment of the present operation, one of the relevant product markets is the market for wholesale (or wholesale supply) of electricity²⁴. The Commission has in previous decisions considered the generation and wholesale supply of electricity to constitute one separate product market²⁵. This encompasses the production of electricity at power stations as well as electricity physically imported through interconnectors for the purpose of resale to retailers. As in other Member States, a few very large electricity consumer may also decide to buy directly from the wholesale market (in Spain, they account for less than 5% of the purchases in the wholesale market).
38. The Commission’s market investigation confirmed that there is at least a separate wholesale electricity market in Portugal. This market has to be seen against the

²² See Case COMP / M.3268-Sydkraft/Grøninge.

²³ Commission Decision 2004/271/EC (Case COMP/M. 2947 - Verbund / Energie Allianz), OJ L 92, 30.3.2004, p. 91.

²⁴ Form CO page 87.

²⁵ See Case COMP / M.3268-Sydkraft/Grøninge.

background of the state of opening of the electricity sector in Portugal. For this purpose, a distinction has to be drawn between the current electricity sector structure and the structure that should soon be in place after the termination of the PPAs²⁶.

39. Under the *current structure*, the vast majority of the market is supplied through the regulated system (SEP) that is to say, under exclusive PPA agreements between REN and power producers. The share of SEP of total Portuguese production plus imports in 2003 was about 80%. About [70-80]*% of this PPA supply is provided by EDP, with the remaining [20-30]*% of supply being shared by two other companies, Tejo Energia and Turbogás²⁷.
40. Outside the PPA scheme, there is a further segment of wholesale supply that is not subject to market prices. This is the segment of “special regime” producers (PREs), composed of cogeneration plants, wind-power and other renewable energies. The electricity produced is sold to REN under regulated tariffs defined by ERSE²⁸. The segment has grown recently and in 2003 accounted for 8% of total electricity wholesale supply in Portugal. In the parties’ view, PRE activity should not be considered a separate market as it will remain a regulated market.
41. The third segment of wholesale supply corresponds to the unbound system (SENV), which operates under free market conditions. Energy traded in SENV accounted for nearly 14% of the total electricity consumption in Portugal in 2003 and is expected to grow in the future. It can be traded either for consumption in the SENV or in the SEP. Bound distributors linked to the high and medium-voltage grid may indeed acquire up to 8% of their consumption on the liberalised market (known as “*parcela livre*”).
42. This segment is composed of (i) Portuguese generation outside the PPAs and PRE’s (i.e. the “unbound” generation), and (ii) of imports from Spain. Today, there are no producers other than EDP in the SENV. Although imports are for now the main source of electricity for SENV, the share of generation is expected to increase further due to the starting of operation, in the beginning of 2004, of EDP’s new gas-fired power plant in Ribatejo (“TER”) which, once fully operational, will account for about [10-20]*% of the overall generation capacity in Portugal and will produce around [5000-6000]* GWh/year, i.e. around [10-20]*% of current electricity consumption in Portugal.
43. The main customers at the wholesale level (both in SEP and SENV) are REN and EDP subsidiaries. REN buys all energy generated under PPA agreements and imports some energy, all for consumption in the public system SEP (above 85% of purchases). The EDP subsidiaries buy energy, on the one hand, for consumption in the regulated system, SEP (above [0-10]*% of purchases) and, on the other hand, for EDP’s customers in the opened market, SENV ([0-10]*% of purchases). Other purchasers are insignificant. There is some degree of imports from Spain by EDP and Spanish players.
44. In the *wholesale market after the termination of the PPA’s*, which is expected in the remainder of 2004 or at the beginning of 2005, the total wholesale electricity market size will not change as compared to the larger view of the wholesale market under

²⁶ EDP reply to the Commission’s request for information of 26 July 2004, submitted on 29 July 2004, pp 2-4.

²⁷ In 2003, the structure of the SEP by producers was the following: EDP accounted for [70-80]*% of the annual generation, Tejo Energia [10-20]*%, and Turbogás [10-20]*%.

²⁸ Only cogeneration electricity can be sold directly to final consumers. However, these sales are limited to companies that consume at least 50% of the heat produced by the co-generator. The co-generation production will represent the difference between production and self consumption of energy by the heat consumer. (form CO p.158).

current conditions (including PPA's and PRE's). However the contractual relations and the price setting mechanism will change dramatically as far as bound generators are concerned, i.e. generators bound to the PPAs. All previously bound generation capacity will then be available on the opened wholesale market which will therefore comprise, on the supply side, the entire Portuguese generation capacity plus imports from Spain. Producers will have to compete in the market for market share. On the demand side, the restructuring of the electricity sector will transfer the role of buyer of electricity for SEP from REN to the regulated retailer, an EDP subsidiary (EDPD), which will be buying energy in the opened market. Other buyers on the demand side will be the companies supplying electricity to their customers in the opened system SENV. It is not excluded that a small amount of very big industrial customers will also be active as buyers on this wholesale market.

45. On the contrary, the termination of the PPAs is not expected to have a significant impact on the framework for the generation of power using renewable energies, namely PRE. This type of power should keep being purchased from generators at the regulated price by a regulated supplier and incorporated in the regulated system. In addition, most of this energy is not dispatchable but produced independently from the demand on the market (for example wind; cogeneration, which depends on the needs for steam of the industrial). This may be done by REN, as it is today, or by the designated regulated retailer, EDP. Irrespective of the latter, this means that the generation in PRE will not constrain the prices of the various players in the wholesale market even once PPAs are terminated.
46. In view of these elements, the question therefore arises whether the relevant market definition should encompass the regulated segments of the market (SEP, which may soon be opened by the termination of the PPAs, and PRE) or whether it should be restricted to the opened part of it (SENV).
47. According to previous Commission decisions, the relevant product market must normally be viewed in the context of the opened segment of the market.
48. Currently, on the one hand, there is a nascent opened wholesale electricity market in Portugal which is, essentially, composed, on the supply side, of the Portuguese generation capacity in the free market and of the imported electricity and, on the demand side, of the companies supplying customers in the free market and of the local distribution companies buying some electricity outside the public system, but for consumption within the public system. On the other hand, there is the regulated area composed of PRE and of PPA "bound" generation with REN as the single buyer which does not yet belong to the same market as the liberalised wholesale market.
49. However, the parties submit that, due to the early termination of the PPAs and the end to the exclusive relationship between REN and some producers, there will be no regulated system any longer at the wholesale level. Consequently, in their opinion, a separation between the liberalised and regulated systems does not make sense when considering the generation/wholesale market. The Commission considers indeed that, as from the termination of the PPAs, there will be a wider wholesale market in Portugal, which will include the offer of the former PPA generation. The assessment will therefore focus on this wider wholesale market.
50. It is worth noting that the parties have not disputed the above-described product market definition in their reply to the statement of objections.

(d) *Balancing power and ancillary services*

51. It has been considered in previous decisions that there is reason to assume a separate product market for balancing power, as it is not easily substitutable with other electricity supply at wholesale level²⁹.
52. It needs to be considered that apart from any supply services that may be required to overcome network congestion, there is a need for suppliers to adjust the electricity they are supplying to the actual (as opposed to the expected) demand of their customers. If demand from a customer exceeds the supplier's planning (and therefore exceeds the amount of energy that it has bought on the wholesale market or can generate itself), there are two options: this supplier is able to correct the deviation itself or it needs to procure the balancing services from somebody else, for instance the transmission system operator who in turn procures the energy needed to perform this service either from the pool or through other contracts with producers who need to be on "stand-by duty" (or arranges for certain electricity consumers to refrain from consuming).
53. There is a technical necessity for such service as the transmission system operator is responsible for maintaining the tension in the grid within a very narrow bandwidth. If there is over-consumption, the tension in the grid would drop and this could cause at some point network stability problems. A problem also arises if there is under-consumption as then the tension in the grid rises above an acceptable tolerance level and the transmission system operator must make sure that either some generation capacity is switched off or that some consumption is added.
54. This service needs to be paid for and there will usually be a "penalty" for deviation if demand of a customer exceeds, or falls below, the expected level which corresponds to the amount that each supplier purchases from the wholesale level or plans to produce himself and which he has to communicate in advance to the transmission system operator.
55. Currently, in Portugal, this service, as well as other similar ancillary services (congestion management services), is provided by REN to all agents in the system³⁰. REN buys all the necessary capacity or energy from SEP generation through the current agreements. Therefore, it does not seem that there is already an established market for such services in Portugal. However, it is likely that, after the termination of the PPAs, such a market will emerge since all previously bound generators will no longer have to sell their electricity to REN. For the purpose of this decision, the exact delineation of this emerging market, or these emerging markets, can, however, be left open.

(e) *Retail supply of electricity*

Description of electricity retail in Portugal

56. Electricity retail supply involves the sale of electricity to the final consumer.

²⁹ The wholesale service that comes closest to balancing power services are so called "intra-day" trading opportunities at which the companies in actual under or oversupply can trade their surpluses or purchase their extra needs. However, if there is no continuous intra-day trading, with immediate delivery, this trading system is in itself insufficient to match supply and demand at any time. Other means of managing it are interruptible customers at no advance warning and customers who are prepared at any time to increase their demand.

³⁰ See Reply to Question 57 of the Commission's questionnaire of 29 June 2004.

57. The retail supply of electricity in Portugal is divided in two segments: the regulated segment (SEP) and the de-regulated one (SENV). In 2003, electricity retail was a 40.9 TWh market, of which 4.0 TWh was de-regulated (SENV) and 36.9 TWh was regulated (SEP).
58. The supply of electricity within the SEP is a regulated activity subject to the national regulator's supervision and can be carried out only by the holder of a license (for distribution at high and medium-voltage) or of a concession (on low voltage at a local level). Customers in the SEP are supplied by the regulated retailer, the current distribution companies (namely, companies which until now have acted both as distributors and suppliers of electricity³¹) which are supplied only by REN and the *parcela livre*. EDP, through its subsidiary EDPD, is the sole distributor at the high and medium-tension level and carries out, almost exclusively, the local electricity distribution function. EDPD's sales thus accounted for [90-100]*% of the sales in the whole National Electricity System (SEN) in 2003.
59. The supply of electricity to eligible customers within the SENV is carried out by free retailers. Retailers supply these customers on the basis of bilateral contracts and for this purpose they have access to the distribution network. There are currently three main operators: EDP, which accounts for [60-70]*% of the electricity that is sold to retail customers in the SENV, Endesa (through a joint venture called Sodesa) and Iberdrola, with 20-30% and 5-10%, respectively.³²
60. On 30.06.2004, consumption by customers who are already eligible accounted for 54% of the Portuguese retail consumption³³. A Decree Law has been adopted on 17 August 2004 (decree-law 192/2004) which provides that all customers in Portugal are now eligible. All customers will have to choose between staying in a regulated market (with regulated prices) or going to the open market.

The relevant product markets in electricity retail

61. The parties submit that, for the purpose of the assessment of the present operation, retail supply of electricity should be considered as a market distinct from the wholesale market³⁴.
62. The parties mention the fact that a large number of customers are now eligible in Portugal and will have the option of switching from supply in the regulated system to supply in the liberalised system. However, they have not taken a position on whether there is a market for all eligible clients or just a market for eligible clients who have actually switched to the open market. For Spain, they cite views on the existence of two separate markets for these two groups of customers.³⁵
63. The market investigation has clearly indicated that the regulated system and the non-regulated system are in the same market: the customers choose freely to be in the regulated or in the non-regulated system according to the price and the conditions in

³¹ In this respect it should be noted that Article 15 of Directive 2003/54/EC provides for the legal unbundling of Distribution System Operators. In particular, this Article establishes that, "where the distribution system operator is part of a vertically integrated undertaking, it shall be independent at least in terms of its legal form, organisation and decision making from other activities not related to distribution", as electricity supply to final customers. This obligation will be only be effective in 2007.

³² See Form CO, Appendix 10, p. 29.

³³ See reply by ERSE to the Commission's Request for information of 28.7.2004, p. 10.

³⁴ Form CO page 87.

³⁵ See reply to question 13 of Art 11 letter of 26.07.2004.

each system. Switching does not entail high costs for the customers. Hence, it has been confirmed that, not only customers switched to the non-regulated market, but also that non-regulated customers switched back to the regulated market. Electricity suppliers are fully aware of this and consequently propose terms and conditions in the non-regulated market referring to the tariff categories of the regulated market.³⁶ Therefore, the Commission takes the view that all eligible customers should be considered, irrespective of whether they are in the regulated or in the non-regulated market.

64. The market investigation has confirmed that two main groups of customers should be distinguished: (i) large industrial customers which are connected to the high (HV³⁷) and medium (MV) voltage customers and (ii) smaller industrial, commercial and domestic customers which are connected to the low-voltage (LV³⁸) grid.
65. High and medium voltage distribution and supply is carried out by EDPD which is the only electricity company which received a license to perform this activity. By contrast, low-voltage distribution is of communal responsibility and can be carried out by communes, companies or local cooperatives under long-term concessions. EDPD holds most of the communal concessions. HV and MV customers have been progressively liberalized and were fully liberalized as from 2003. The liberalisation of the LV customers started in the beginning of 2004 and was fully achieved with the adoption of decree-law 192/2004 on 17.08.2004. In 2002, according to EDP³⁹, there were 109 HV customers, 20377 MV customers and 5.6 million LV customers. In terms of consumption, the breakdown into these customer groups was the following: 4271GWh⁴⁰ for HV, 11 186GWh for MV and 19410GWh for LV customers.
66. HV/MV customers and LV customers are very different as regards their consumption and the terms and conditions under which they purchase electricity: in 2003, the average consumption of LV customers was of 3.5 MWh⁴¹ while that of MV/HV customers was as high as high 750MWh. Prices paid are also very different: in 2003, in the regulated system, LV customers paid about 120 EUR/MWh⁴². By contrast, MV/HV customers' prices on average were as low as 63 EUR/MWh. The structure of tariffs is also distinct: HV and MV share the same formulae over the same periods of the year or of the day (with different coefficients to take account of the different voltage), which include a fixed term and payments for capacity, active energy as well as reactive energy. LV tariffs are much simpler both in terms of formula (only capacity and active energy) and much smaller number of periods (and only within a day). The consumption profile is also very different: the consumption of large industrials is very stable over

³⁶ [...]

³⁷ Hereinafter HV encompasses both high voltage and very high voltage.

³⁸ Hereinafter, LV encompasses all types of low voltage, i.e. normal and special. The consumption of "special low voltage" accounts for only about 15% of of total low voltage consumption and "normal low voltage" customers (households) are therefore clearly the dominant group of customers in LV. Similarly, the special low voltage group would only account for a small percentage of the consumption if it were considered part of the large customer market. The attribution of special low voltage clients to the household market or to the large businesses market is therefore irrelevant for the purposes of product market definition in this communication and does not need to be discussed any further.

³⁹ Data from EDP's web site

⁴⁰ Source: EDP's web site:

<http://www.edp.pt/index.asp?LID=EN&MID=2&OID=8030000&PID=8000000&CID=206210>

⁴¹ Source: EDP's web site:

<http://www.edp.pt/index.asp?LID=EN&MID=2&OID=8030000&PID=8000000&CID=206210>

⁴² Source: EDP's web site:

<http://www.edp.pt/index.asp?LID=EN&MID=2&OID=8030000&PID=8000000&CID=206210>

time, with a decrease in the load during the week-end. On the contrary, smaller customers such as commercial and household customers have very fluctuating demand within a day.

67. The commercial relationship is also very different. MV and HV customers are for the most part large industrial customers for which electricity may account for a significant part of their costs. Electricity demand in this case often relates to powering dedicated applications, i.e. processes consuming large quantities of electricity. They also usually have procurement departments, i.e. the necessary resources to carefully study the commercial offers that they receive and compare terms and conditions. These customers are more sensitive to prices, request customised solutions to fit as closely to their needs as possible as well as auditing services to optimise their energy bill. In particular, they may require frequent and precise metering solutions in order to make consumption information available to inform decision making. They are more prompt to switch supplier. As a result, sales representatives usually take care of these large accounts on an individual basis.
68. On the contrary, most LV customers are small industrial, commercial or domestic customers (with a large preponderance of household customers both in number and volume of consumption), whose consumption of electricity per customer is quite limited in volume. Electricity may not account for a significant factor in their total spending. They usually have more limited resources to compare terms and conditions proposed by the various suppliers. They tend to prefer standard and simple conditions (such as fixed rates) which allow them to limit the resources involved in dealing with the purchase of electricity without losing visibility on what they pay. These customers are less sensitive to prices and are less prompt to switch supplier. These small customers are characterised by a mass marketing approach, both to spread the cost of capturing and serving customers and because the customer awareness appear to come from less direct methods of marketing such as mass-market advertising and branding. In this context, brand familiarity is one of the highest valued attribute in pricing.
69. The difference between these two types of customers is evidenced by the switching rates witnessed in other electricity markets Europe. DG TREN's estimated figures⁴³ for supplier switching rates of on the one hand large industrial customers and on the other hand small commercial and household customers for the year 2002 : Austria 15% vs 5%, for Germany 20% vs 5% and for Ireland 20% vs 2%.⁴⁴ In Spain, the switching rate of suppliers in the first half of 2004 was much higher with MV/HV customers (56%) than with LV customers (6%).⁴⁵

⁴³ These figures take into account only eligible customers in countries where not all customers are eligible (deadline set by the directive is 1.7.2007 for households)

⁴⁴ DG TREN, Draft Working Paper: Third benchmarking report on the implementation of the internal electricity and gas market, Brussels, 1.3. 2003., Table 4. The only countries which showed comparable switching estimates were the UK and Norway.

⁴⁵ Above figures are for switching rates by consumption. Differences in switching rate per number of customer are equally significant. Within LV switching rates were lower with households than with SMEs. It is furthermore noticeable that LV customers tended to switch to a supplier of the same group (i.e. switch from the regulated supplier to the "commercializadora" supplier of the same group) to an even larger extent than HV/MV customers: values for intra-group switching were 83-85% for the two LV subgroups whereas they were 75-77% for the two HV/MV subgroups.
(http://www.cne.es/pdf/IAP_evolelectricidad.pdf)

70. This distinction between small customers and large business customers is reflected in EDP's business approach. [...] ⁴⁶
71. Finally, such approach also corresponds to business organisation and marketing approach of competitors. Endesa explains the important distinctions they see between high and medium voltage customers on the one hand and low voltage customers on the other hand as follows (summarized):
- HV: For high and medium voltage customers the conditions of competition are quite similar. Customers have negotiating power and normally have several meetings with the sales force before signing a supply contract. High and medium voltage customers are more influenced by price and margins per unit are lower. These customers ask for personalised products and services (for example, management portfolio, added value services).
- LV: Low voltage customers receive standard offers, are contacted via telemarketing and have less capacity of negotiation than the other two groups. To achieve switching with low voltage customers is more difficult because their electricity expenditure is less important therefore an important effort in communication and promotion is needed to motivate customers to switch. Special entry barriers such as branding, expensive information systems, call centers exist vis-à-vis this group. ⁴⁷
72. Lastly, it is worth noting that the parties have not disputed the above-described product market definitions in their replies to the statement of objections.
73. As a result of the above, the following electricity retail markets will be considered for the purpose of the present decision: (i) the supply of electricity to Large industrial customers (high and medium voltage) and (ii) the supply of electricity to smaller industrial, commercial and domestic customers (low voltage).

3. Geographical markets in electricity

74. The notifying parties submit that the geographic scope for the wholesale market coincides with the Iberian Peninsula whereas, for the retail supply, the relevant geographic market could be deemed as national ⁴⁸.

(a) Transmission and distribution grids

75. As stated above, each transmission and distribution grid constitutes a geographic market of its own.

(b) Wholesale of electricity

76. In past Commission decisions, the relevant geographic market for the wholesale supply of electricity has been considered to be no wider than national borders. ⁴⁹. Even as

⁴⁶ [...]

⁴⁷ Endesa's reply to questions 1-4 of the Commission's request for information of 17.9. 2004. See also replies of Centrica and of EDF.

⁴⁸ Form CO, page 87.

⁴⁹ See for example Commission Decision 2004/135/EC (Case M. 2434 – Grupo Villar MIR/ENBW/Hidrocantabrico) OJ L 48, 18.2.2004, p. 86.

regards the Nordic countries, where the integration of markets seems to be most advanced within the EU, the Commission has so far expressed doubts whether wider than national markets can be assumed.⁵⁰ Nevertheless, the parties submit that the relevant market for electricity wholesale supply will be Iberian in scope in the short term because of the political agreements between the Spanish and the Portuguese governments, entered into in January and October 2004, calling for the creation of the MIBEL and the planned increase in interconnection capacity between Portugal and Spain.

77. On the basis of the in-depth investigation carried out by the Commission, it can be concluded (1) that the relevant market is currently national in scope and (2) it is highly unlikely that, notwithstanding the political agreement reached by the governments of Spain and Portugal, it will become Iberian in scope in the near future.

Currently, Portugal clearly constitutes a distinct geographic market

78. Regarding the current situation, the Commission’s investigation has confirmed that the wholesale electricity market in Portugal is national in scope not only because the Spanish and the Portuguese regulatory framework and market operating rules still remain substantially different but also because the current level of interconnections is clearly insufficient for the establishment of a single market in the Iberian peninsula.

The current level of interconnections between Spain and Portugal is not sufficient to consider the existence of a single market in the Iberian peninsula

79. In previous recent decisions regarding the electricity markets in Spain⁵¹, the Commission already found that the limited interconnection capacity available between Spain and Portugal prevented, amongst other factors, the emergence of a truly Iberian market. This was again confirmed at the end of last year by the Spanish and the Portuguese regulators, according to which “*the current level of interconnections between the two countries is not sufficient to integrate completely the systems of the two countries*”⁵². Indeed, the levels of available interconnection between Spain and Portugal remain insufficient to allow a significant flow of electricity between Portugal and Spain.
80. In 2003, imports from Spain occurred mainly for supply to the opened wholesale market. These imports accounted for about 9% of Portuguese total wholesale supply.⁵³
81. As shown by the table below based on the parties’ figures, the interconnection capacity from Spain to Portugal represented only 7-13% of the capacity needed at peak demand times in Portugal in 2003.

	2003
Peak demand	8046 MW

⁵⁰ This has been confirmed by a recent decision of a national competition authority which assumed two relevant electricity wholesale markets no wider than Denmark : decision: Elsam / NESA; <http://www.ks.dk/konkurrence/afgoerelser/2004/R2403/elsam/>

⁵¹ See for example Case M.2684 - EnBW/EDP/Cajastur / Hidrocantabrico; and Case 2620 – Enel/Viesgo: OJ C 364, 20.12.2001, p. 14.

⁵² “Comentários da CNE/ERSE às soluções acordadas sobre o mercado ibérico da electricidade”, 19.12.2003, by ERSE and CNE

⁵³ See Form CO, Annex 10, p.23.

Interconnection capacity (Summer)	600-850 MW	7-11%
Interconnection capacity (Winter)	750-1050 MW	9-13%

Source: parties, based on information by REN⁵⁴

82. In addition, it is noteworthy that the level of interconnection between Spain and Portugal depends on the internal load in each national system. Increased loads in the national systems, in particular at times of high demand, may tend to limit the interconnection level available, thus reducing the ability for imports to play a role in Portugal. As a result, when there is peak demand, the level of interconnection commercially available is on average lower than the figures indicated in these tables (which are average values).
83. In the first half of 2004, there were congestions⁵⁵ from Spain to Portugal during 25% of the time on average, with an increase of up to 50% in the months of May and June.⁵⁶ In July the percentage of interconnection congestion even rose to 66%⁵⁷. In August congestions occurred 47%⁵⁸ of the time. CNE, the Spanish energy regulator, considers that nowadays the congestions between Spain and Portugal are almost permanent⁵⁹. It is self-evident that such level of congestion is not compatible with the idea of an Iberian market.

These levels of congestions are not due to exceptional circumstances and are likely to keep occurring in the near future

84. As indicated above, the level of congestions in the first months of 2004 was in the range of 25%. It must be underlined that a congestion level of 25% is already extremely high: it means for an electricity player who wishes to import electricity (such as Iberdrola or Endesa who rely exclusively on imports to supply customers in Portugal) that it will not be able to import the quantities it planned to import in order to supply its customers 1 time out of four and that it will not be able to predict precisely when the congestion will occur. Such a level of congestions is much higher than the levels of congestions observed on the Nordic electricity pool, which are in the range of 0% to 7% of the time.⁶⁰

⁵⁴ Interconnection capacity: Form CO, page 112; Peak demand: Form CO, Annex 13, p. 163.

⁵⁵ Congestions occur, for instance as regards imports of electricity from Spain to Portugal, when the state of the electricity networks and the transport capacities are such that the electricity that was planned to be transported from one point to another cannot be entirely physically transported. It is worth noting that the amount of electricity that can be transported through the interconnectors between Spain and Portugal also depends on the available transport capacity upstream and downstream of the interconnectors.

⁵⁶ Form CO, page 117

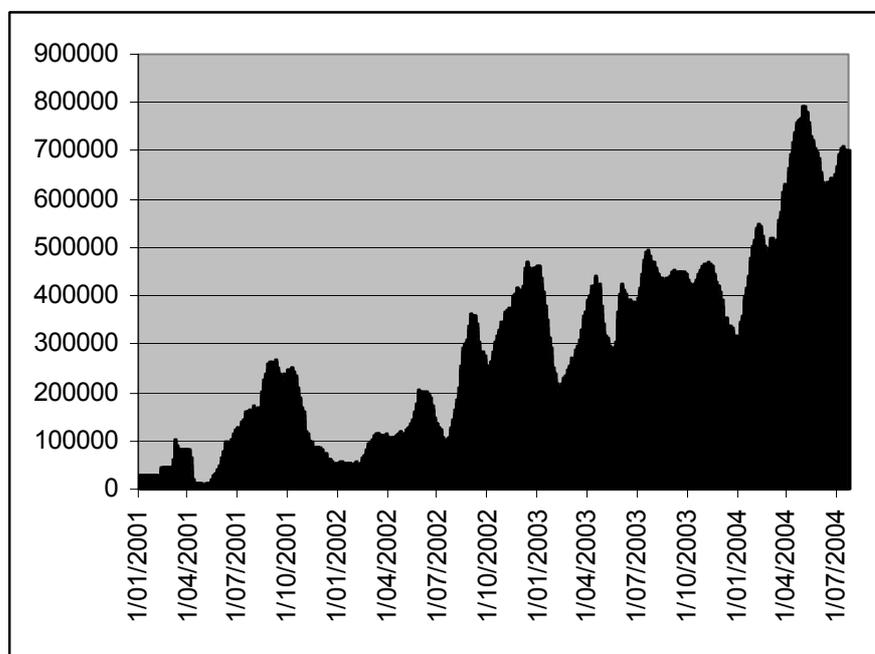
⁵⁷ EDP's answer to the Commission's Art. 11 request of 24.8.2004. Q15.

⁵⁸ Data provided by REN in reply to the Commission's Art. 11 request of 23.7.2004, updated on 8.10.2004.

⁵⁹ Minutes of meeting with CNE on 07.09.2004. All minutes referred to in the present document have been reviewed and approved by the participants.

⁶⁰ In its decision Sydkraft/Granninge of 30.10.2003 (case COMP/M.3268, p. 26) the Commission found that Sweden was isolated from all other areas in the Nordpool area only 5,5% (2000) 0,0% (2001), 0,1% (2002), and 0,0% (Jan –Sept 2003) of the time. Isolation percentages between individual neighbouring territories and Sweden were somewhat higher but also generally low (eg. on average 7% between Sweden and Denmark East in the same period). Even though the Commission considered that the

85. In addition, higher levels of congestions have even been observed in the following months of 2004 (up to 66%). Several factors can explain this increase. First, as underlined by the parties in their reply to the 6(1)(c) decision, the level of interconnection is further reduced in summer: higher temperatures lead to a reduction of the capacity available in the lines by up to 20%-25%. Second, as shown in the graph below, there has been over the past years a clear increase in the imports of power from Spain, which are now significantly limited by the interconnections.



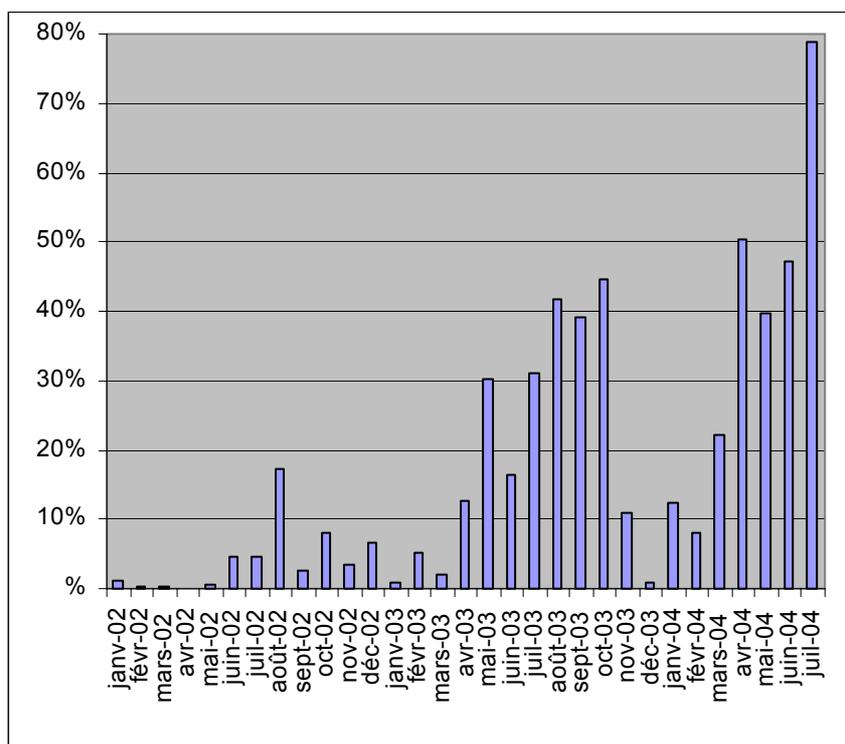
Electricity imported monthly from Spain into Portugal from January 2001 to July 2004⁶¹

86. Such imports should keep developing in the near future within the tight limits imposed by interconnections. Thus, in the first weeks of July 2004, the percentage of interconnection congestions has reached 77%. The parties argue that “*the percentage of 77% of interconnection congestion during the first 19 days of July [2004] must be seen as an exceptional case*” due to “*conjunctural market dynamics*” and to “*a lesser extent, a dryer year 2004 compared to 2003*”⁶². However, the Commission observes that the level of congestions follows an overall upward trend as described above. As a result and understandably, average congestion levels on monthly basis have been lower in the past. Nevertheless, congestions occurred one third of the time on a comparable period in 2003 (July). They reached 44% of the time in October 2003. Even though these levels of congestions (between one third and one half of the time) are lower than those observed in 2004, they are entirely incompatible with the idea of a single electricity market between Spain and Portugal.

generation/wholesale market might be larger than Sweden, it left open the precise scope of the geographic market.

⁶¹ Data provided by REN further to the Commission’s Art. 11 request of 23.7.2004.

⁶² Para 32 of the parties’ reply to the 6(1)c decision.



Percentage of the time congestions occurred on a monthly basis from January 2001 until July 2004.⁶³

The termination of the PPAs will not change the import/congestion levels

87. The termination of the PPA contracts which is expected in 2005 seems unlikely to dramatically impact on the level of imports from Spain and thus on congestions. The parties explained the congestions as follows: *“Given that most of EDP’s generation capacity is tied up by PPAs and that under this regime, EDP is not able to control its plants and to generate directly to its needs, EDP has also to import in order to supply its SENV demand like the rest of market players as Endesa and Iberdrola”*⁶⁴. However, this situation has already changed since January 2004 when EDP’s new CCGT started producing power for EDP’s customers in the opened market. Nevertheless congestions have kept increasing from 25% in the beginning of the year up to 66%⁶⁵ in July 2004.
88. In their replies to the statement of objections⁶⁶, the parties consider that (i) the role of REN as well as (ii) the supply of SENV and the *“parcela libre”*⁶⁷ should be taken into account when assessing the termination of the PPAs. As regards the former, the parties underline that REN currently imports and exports significant amounts of electricity between Spain and Portugal. Once PPAs are terminated, REN will cease to be the single buyer and hence to import/export power. However, in the same part of the reply, the parties also underline that *“these exchanges represent a structural usage of the interconnection”* and that they *“would be likely to be maintained after the termination of the PPA, even though carried out by other operators in the market”*.

⁶³ Data provided by REN further to the Commission’s request on 23.7.2004.

⁶⁴ The parties’ submission on 27.09.2004.

⁶⁵ Data provided by REN further to the Commission’s request on 23.07.2004.

⁶⁶ EDP’s reply on 28.10.2004

⁶⁷ Up to 8% of the electricity consumed in the regulated system can be bought in the free system, SENV. This part is called the *“parcela libre”*.

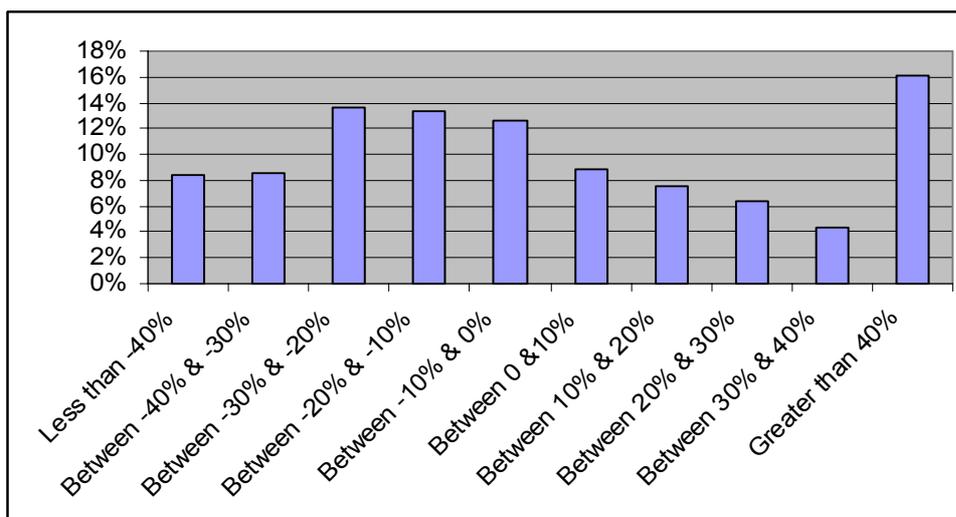
89. As regards the latter, the parties underline that, in the current regulatory framework, the power supply in SENV cannot rely on the generation capacity of SEP, but only on the unbound generation and the imports. Once PPAs are terminated, the parties argue that the SENV suppliers will have access to alternative source of supply to imports and EDP will not import power any longer to supply the regulated system (through the *parcela livre*). Accordingly, this would have an impact on the level of imports. However, the Commission does not consider that the above-described modifications will lead to significant changes in the import patterns.
90. Firstly, most of the generation capacity which will be available to supply SENV customers after the termination of the PPAs belongs to EDP: it is unlikely that EDP's competitors decide to stop importing the electricity they produce in Spain to depend on EDP's capacities. Second, the entry into service of the first unit of TER, owned by EDP, at the beginning of this year gives indications on the possible impact of PPAs as regards the *parcela livre*. TER is the first and so far only significant generation capacity which has appeared in the unbound system and can be used to supply SENV. TER's first unit can generate close to [...]GWh per month. By contrast, the *parcela livre* represents around [...]GWh per month as explained by the parties in their reply. Therefore, as will be the case once PPAs are terminated, the launch of TER's first unit at the beginning of 2004 already allows EDP not to use imports to address the *parcela livre*. However, this has not resulted in lower imports or congestion levels in the course of the year 2004. Therefore, even though the termination of the PPAs do bring about modifications in the regulatory framework, it is very unlikely that it will dramatically impact on the level of imports or congestions.

Price differentials between Spain and Portugal

91. The Commission also analysed the price differences at the wholesale level between Spain and Portugal. The Spanish wholesale prices are those of the Spanish pool. The Portuguese wholesale prices cannot be accessed as directly as Spanish ones, since 90% of the market is bound by PPAs and there is no pool. However, REN, as the single buyer, has the responsibility of dispatching all the generation capacities bound to SEP (that is, more than 95% of the wholesale market in Portugal). Each plant has a certain variable cost, which REN pays, within the Portuguese merit order. As a result, REN tries to match supply and demand all the time at the lowest cost and computes the marginal price of the system hour by hour, depending on which plants have been dispatched and which plant is the marginal one (meaning the one which sets the price of the system). The marginal price of the system⁶⁸ has been provided by REN to the Commission along with the price on the Spanish pool that REN would pay if it decided to import power from the pool (it includes transport charges payable to the Spanish electricity network operator REE).
92. The comparison of prices between Spain and Portugal on an hourly basis between January 2001 and August 2004 indicates that these prices are poorly correlated and fluctuate a lot from each other. The graph below shows the proportion of the time, the price in Portugal has been between x% and x%+10% higher than that of Spain. X varies between -40% and +40% In particular, it can be concluded from this graph (by adding the percentages of the first three columns and of the last three columns) that the

⁶⁸ This price is the one of SEP (including REN's imports from Spain), not of the entire Portuguese wholesale. However, given that the generation in SENV is very limited (only 600MW for the time being as compared with a total generation of 12000MW in Portugal), the difference is *de minimis*.

two prices are different from each other by more than [20;30]*% for [50;60]*% of the time.



Percentage of the time during which the price in Portugal has been between x% and x%+10% higher than that of Spain

93. In their replies to the statement of objections, the parties do not dispute that the electricity wholesale supply is currently national in scope and will remain so in the near future.

It is highly unlikely that the wholesale electricity market will effectively be Iberian in scope in the near future

94. Despite the fact that, currently, it is not possible to consider that the relevant market is Iberian in scope, the parties point out that a “*transitory market approach*”⁶⁹ should be adopted which takes into account future changes that, in their view, are bound to happen in the context of the creation of MIBEL.
95. Pursuant to the Commission Notice on the definition of the relevant market for the purposes of Community competition law⁷⁰, “*A process of market integration that would, in the short term, lead to wider geographic markets may be taken into consideration when defining the geographic market for the purposes of assessing concentrations and joint ventures*”. In particular, “*a situation where national markets have been artificially isolated from each other because of the existence legislative barriers that have now been removed will generally lead to a cautious assessment of past evidence regarding prices, market shares or trade patterns*”⁷¹.
96. Accordingly, in the context of the discussions taking place between the Portuguese and the Spanish Governments regarding the creation of the MIBEL, the Commission has conducted a cautious analysis of the various elements brought to its knowledge in order to assess whether there is a sufficient likelihood that this process would lead to a wider geographic market in the short term.
97. In previous decisions, the Commission had already considered that, despite the existence of a political agreement, “*the emergence of a truly Iberian market would still*

⁶⁹ Form CO, page 119.

⁷⁰ OJ C 372 9.12.1997, p.5

⁷¹ See Notice at paragraph 32.

*be hindered in the coming years by the limited interconnection capacity between Spain and Portugal, and furthermore, will depend on the progressive implementation of a number of successive steps, that include not only technical measures on the electrical grids and the interconnectors but also the elimination of regulatory and administrative barriers and the harmonisation of the functioning and management methods of the systems' operators*⁷².

98. For the reasons stated below, several elements show that the effective integration of the Portuguese and Spanish wholesale electricity markets is still far from certain and do not permit the assumption of an Iberian market in the short term for the purpose of the assessment of the concentration.

Many important regulatory barriers have still to be removed for the purpose of the establishment of the MIBEL

99. In the Commission's investigation, a large number of respondents underlined that one of the decisive steps for a future integration of the Portuguese and Spanish electricity markets is the establishment of a common regulatory framework and a common framework for market operation (coordinated management of both electricity systems, unified spot and forward wholesale markets).
100. It has first to be recalled that, up to now, the establishment of the MIBEL is itself only a first step towards an Iberian wholesale electricity market.
101. Moreover it has been postponed on several occasions. Thus, the Collaboration Protocol signed in 2001 between the governments of Portugal and Spain initially established a start date of January 2003. Subsequently, another agreement was entered into in January 2004 and postponed the starting date to April 2004. This latter date has, in turn, been subsequently postponed. In that respect, the parties indeed acknowledge that the effective entry into force of the MIBEL has been delayed but they submit that "the delay is merely temporary"⁷³. For his part, the Portuguese Minister of economy underlined that the dates initially planned by the previous government appeared to have been quite optimistic⁷⁴.
102. The parties argue that, in any case, "*this postponement has limited consequences as it did not prevent each of the governments from continuing to pass national legislation.*"⁷⁵ Nevertheless, at this date, not much specific legislation has been passed in Portugal with respect to the entry into force of MIBEL. The only decree-laws referred to by the parties which were passed since the two governments signed the 2004 Agreement are decree-laws relating to the extension of the eligibility criteria to all consumers, that is, relating to the implementation of Community legislation rather than to the setting of the MIBEL.
103. These successive delays and the absence of the necessary national legislation to effectively implement the MIBEL are due to the fact that many regulatory issues remain to be addressed in the discussions between the governments, before any effective harmonisation takes place through national legislation within each country.
104. Indeed, for the moment, the January 2004 Agreement between the Spanish and the Portuguese governments only related to some general issues. As explained by the

⁷² See Case M.2684 - EnBW/EDP/Cajastur / Hidrocantabrico, paragraph 25.

⁷³ Paras 6 and 7 of the parties' reply of 3.9.2004 to the Commission's 6(1)c decision.

⁷⁴ "Hubo optimismo por parte del anterior gobierno a la hora de establecer las fechas", ABC, 9.9.2004.

⁷⁵ Para 8 of the parties reply of 3.9.2004 to the Commission's 6(1)c decision.

parties, the innovations provided by this Agreement are the following: (i) the trading of electricity within the MIBEL should take place either through bilateral contracts between generators, retailers and end-consumers, or through a spot market, the functioning of which would be inspired on the functioning of the Spanish pool, and through a financial derivatives market; (ii) a single market operator should be created by April 20, 2006, by merging the Spanish market operator (currently known as “OMEL”) and the Portuguese market operator; (iii) operators authorized to operate in one country should automatically be entitled to operate in the other one and (iv) a “market agent committee” should be created.

105. These features remain very general and are still to be implemented. As the Spanish electricity market operator, OMEL, recently put it, *“Up to this moment the only thing discussed by the government of Spain and Portugal are institutional issues related to electricity market operators”*⁷⁶. According to the electricity grid operator in Spain, REE, it also follows from this situation that *“when and how the MIBEL is going to develop is highly uncertain.”*⁷⁷
106. Although the parties concede that *“there are still aspects that remain to be defined”*, they argue that this lack of harmonisation is not sufficient to prevent the geographic dimension of the market to be considered as Iberian because *“there is an ongoing process of study and preparation of the specific measures to contribute for the creation of this new market dimension”*⁷⁸.
107. Such a process of study and preparation does not amount to the effective adoption of specific measures and, therefore, it is not possible to consider, as required by the Notice on market definition, that *“the legislative barriers [...] had now been removed”*.
108. In addition, the market investigation clearly confirms that the regulatory issues that remain to be addressed are far from minimal but, on the contrary, are crucial for the effective implementation of the MIBEL. These issues would still need to be agreed upon and subsequently harmonised by legislation before MIBEL can actually start.
109. Thus, as explained by the Spanish electricity market operator, OMEL, *“until some level of harmonisation is in place, MIBEL cannot start. Tariffs, ancillary services, balancing mechanisms, REN situation as compared with REE and OMEL situation, all these things need to be harmonised to [an] accepting level for MIBEL to start”*.⁷⁹
110. According to the electricity grid operator in Spain, REE: *“At the technical and regulatory level, many things still need to be done. In particular, defining the details of the regulatory environment in which MIBEL should develop has proved to be much more difficult than expected. Regulations on each part of the border are very different and bridging this gap may take a lot of time. Issues that are complex and not solved so far are numerous, for example: the role of bilateral contracts, the very different structure of tariffs on both sides⁸⁰ or the way congestions should be managed.”*⁸¹

⁷⁶ Slide presentation by OMEL on 26.8.2004.

⁷⁷ Minutes of meeting with REE, on 26.8.2004.

⁷⁸ Para 24 of the parties’ reply to the Commission’s Art. 6(1)c decision.

⁷⁹ Slide presentation by OMEL on 26.8.2004.

⁸⁰ The new agreement between the Spanish and Portuguese governments provides for an additive tariff structure but leaves open when this will be implemented. A bare plan is to be presented by 30.6.2006 (Acordo entre a República Portuguesa e o Reino de Espanha relativo à Constituição de um Mercado Ibérico da Energia Eléctrica., Santiago de Compostela, 1.10.2004. Article 9).

111. The Portuguese energy regulator, ERSE, has largely confirmed the need to modify and harmonise national legislations on several important aspects. In particular, as regards “the development of the national regulation necessary for a well functioning market”, ERSE states that:

“These rules should be laid down in the electric sector regulations (ERSE’s domain of competence) and they should promote simplicity, stability and flexibility in the procedures. In order to achieve this objective, a process where all regulations will be revised will be initiated. In such a process, the following points will have to be addressed and defined:

- *The rules for commercial relationships, mainly those that allow consumers to choose the supplier, the procedures allowing consumers to switch among suppliers, the mechanisms of choice and availability of consumption data, as well as the obligations of the regulated trader vis-à-vis the acquisition of electric energy and consumers.*
- *The tariffs applicable both to the access to the networks and to the supply of the regulated supplier, taking into account a fair remuneration of the activities and the non-existence of cross-subsidisation amongst activities and groups of consumers.*
- *The rules for the access both to the networks and interconnections that include the agreements defining the capacity of interconnection, the allocation of such capacity among the agents and how congestions are solved.⁸²*
- *The rules concerning the system operation, mainly at the planning and coordinated management of the systems levels.*

[...]*

Thus, the activities to be developed together with CNE can be resumed as follows:

- *Processing rules for the functioning of the market taking into account the Agreement that ERSE and CNE entered into.*
- *Creating a platform for a joint action with CNE.*
- *Processing rules in order to harmonize the tariffs in both countries.*
- *Processing harmonized rules to accommodate consumers’ switching, including technical specifications of the equipments and systems of “telecounting”, protocols for counting communicating, collection and processing of information.*
- *Processing rules concerning the definition of the interconnection capacities, their allocation across the agents and how to solve the congestions taking into account the Regulation (CE) n°1228/2003, of 26 June.*

112. ERSE also mentions other important institutional and operational issues that would have to be addressed:

“The creation of the Council of Regulation and the definition of its rules of functioning:

⁸¹ Minutes of meeting with REE, on 26.8.2004.

⁸² The new agreement between the Portuguese and Spanish governments provides that such allocation should be done on the basis of market mechanisms. However, it does not provide the rules for such allocation nor the timeplan for agreement on such rules. Acordo entre a República Portuguesa e o Reino de Espanha relativo à Constituição de um Mercado Ibérico da Energia Eléctrica., Santiago de Compostela, 01.10.2004.

- *Processing rules establishing the procedures for infringements contained in the Agreement, as well as establishing extrajudicial solutions for conflicts regarding the economic and technical management of the system.*
- *Processing rules for monitoring the functioning of the market.*
- *Processing rules for monitoring the technical management of the transport system, mainly at the planning and coordinated operation of the systems levels.*
- *Processing rules for articulating and sharing information between the market operator and the electric system operators.*
- *Processing rules concerning the information to be provided to the consumers and remain market agents.*
- *Processing studies that define monitoring indicators.*
- *Definition of mechanisms for collecting information which is necessary to the monitoring activity.*^{83 84}

113. Furthermore, it is far from clear that all of these regulatory barriers which still have to be harmonised can be easily solved in the short term between all the various public bodies involved in this process. Many contentious issues remain, thereby rendering the date of effective entry into force of the MIBEL all the more uncertain.

114. For example, as explained by OMEL, “Currently there at least five contentious issues:

- *Technical operation of the electricity system (Spain: market-based, Portugal: tariff-based). EDP would benefit from technical constraints in Portugal at the expense of Spanish firms with clients in Portugal.*
- *Long-term contracts between EDP and REN. It is necessary to ensure that in breaking up these contracts, conditions are similar and compatible with the approach followed in Spain. In particular, it appears the stranded costs will be compensated at a higher price in Portugal than it was the case in Spain (€3.6 kw/h or 6pts). Also there is a different timing. In Spain they will end in 2007 and 55% of CTCs have already been paid. Finally the coverage is also much larger in Portugal, with up to a 90% of the energy). The different level of compensation which in the next years will get the Portuguese and the Spanish companies and the fact that the Portuguese compensation scheme will continue after the end of the Spanish one create a clear disincentive for the Spanish authorities to effectively launch the MIBEL.*
- *Gas Market. The linkages between the gas and the electricity market at an Iberian level have not been discussed. In the MIBEL “gas does not exist”.*
- *Bilateral contracts. Limitations are required for the MIBEL to work effectively given the current market share levels. Otherwise there would be no liquidity in the market. For example bilateral contracts should not be allowed among the 5 largest players. In the Nordpool there are many bilateral contracts but there is little vertical integration and hence the market remains competitive. The regulator’s idea to only block intra-group contracts will not work in practice.*

⁸³ ERSE’s reply of 6.8.2004

⁸⁴ The recent agreement between the Spanish and Portuguese governments provides that such a Council of Regulation shall be set up, having some supervisory and advisory functions. However, no deadline for the setting up of the Council is mentioned in the agreement (Acordo entre a República Portuguesa e o Reino de Espanha relativo à Constituição de um Mercado Ibérico da Energia Eléctrica., Santiago de Compostela , 1.10.2004, Article 11)

- *REN's current role as both a system operator and market agent is sharply different from the division between OMEL and REE in Spain. REN is currently a very active buyer and acts as a broker. All of these issues must also be resolved before starting the MIBEL. Negotiations on each point are progressing slowly if at all.*"⁸⁵
115. The market investigation also indicates that there are diverging views on other important issues, such as the type of congestion management which is the most efficient and which should eventually be retained. In that regard, according to the Spanish regulator, CNE, which would jointly elaborate such rules with ERSE, "*a counter-trading solution is not ideal as it could bring along strong risks of manipulations. The drawback of the market splitting is that EDP will be able to set the price in the Portuguese market, as it controls 70% of the production capacity and 60-70 % is necessary to cover the Portuguese demand.*"⁸⁶
 116. Finally, it has to be noted that, even if agreements could ultimately be reached on those various regulatory issues between the public bodies involved in the process, important changes would still have to be implemented in the Spanish and Portuguese legislations. As explained by REE, "*In this sense, several important points of the national Portuguese and Spanish regulation require changes to obtain a necessary degree of harmonisation before the Iberian daily market can start*"⁸⁷.
 117. For instance, ancillary services would have to be regulated in a common way in Spain and in Portugal, which is not the case yet. According to OMEL, "*as regards the ancillary services market there are sharp differences between Spain and Portugal. In Spain a market exists and is the responsibility of the regulator. In Portugal, in contrast ancillary services are regulated*"⁸⁸
 118. With respect to the type of trading model which should take place within the MIBEL, an important revision of the current Spanish legislation would also be necessary. As explained by REE, "*In 2003, ERSE and CNE published a theoretical model for the MIBEL, in which bilateral contracts accounted for most of the exchanges of power and the pool was used only for adjustments. If this is the case, it means that the current organisation in Spain has to be deeply revised as the bilateral contracts are the exception nowadays. It also implies that the parties to a bilateral agreement will have to book capacity too. They will run a risk when this includes the interconnection between Portugal and Spain and will have to find local back-ups.*"⁸⁹
 119. The same requirement of further harmonisation would apply with respect to tariffs in the regulated markets. The importance of this issue for the effective launch of the MIBEL is explained by REE in the following terms: "*The harmonisation of tariffs in the regulated market is also crucial for the MIBEL to work properly. [...]** *The tariff has also a significant impact on the switching rate of the customers to which a given tariff applies. But the tariffs payable by the same tariff customer in the two countries are different and the same customer will have different incentives to switch. In Spain, for instance, most large industrial customers have not switched to the liberalised market because the tariffs are more interesting. Harmonising these tariffs is very*

⁸⁵ Minutes of meeting with OMEL, 26.8.2004

⁸⁶ Minutes of meeting with CNE, on 7.9.2004

⁸⁷ "*Advances in the development of the Iberian power market (MIBEL) model*", REE, C5-111, 2004.

⁸⁸ Minutes of meeting with OMEL, 26.8.2004

⁸⁹ Minutes of meeting with REE, on 26.8.2004.

difficult as i) it requires a strong political will (tariffs are one of the last economic instruments to drive the economy) and (ii) it cannot be done abruptly otherwise it can have dramatic economic impacts. In Portugal, tariffs were rapidly increased by 20% for some large consumers two years ago. This created much instability and uncertainty for large customers. But the issue is not only one of the price-level of the tariff but also of the structure of the tariffs. So far, Spain wants to keep its system of “average tariffs”, while Portugal wants to keep its “additive tariffs”.”⁹⁰

120. The latest meeting between the Spanish and the Portuguese governments dates from 1 October 2004. A new agreement⁹¹ has been signed which foresees that the MIBEL should start on 30 June 2005. The agreement has been entered into for a two-year period and first needs to be ratified according to the national provisions. It may be amended at any time or unilaterally terminated at the end of this period. This agreement reiterates most of the principles that had been proposed for the working of the MIBEL in the previous agreements and protocol. In addition, this recent agreement also mentions numerous technical and regulatory issues which have to be solved before the MIBEL, or certain provisions relating to the implementation of MIBEL, can actually start entering into operation. The agreement, however, does not provide these solutions but frequently refers to further bilateral agreements that need to be reached at various levels without providing clear guidance on the solutions to be found or on the time frame for implementation. For important issues there are no deadlines at all. The day-ahead market, to be operated by OMI-E, the Spanish pole of OMI and successor of OMEL, is suspended for a transitory period which has not been defined. For the harmonisation of tariffs only a “plan” needs to be presented by 30 June 2006. For instance, it is already clear that the system operators will remain separate and will set up two independent and mutually exclusive systems of ancillary regulating/balancing services. Crucial issues such as how the grid operators will coordinate and what provisions exactly will apply to regulated suppliers remain unsolved. It is not yet clear how the historic contracts (such as that of REN with Transgás/Turbogás) will be properly terminated nor how and according to which timeframe congestion management and interconnection capacity allocation should be agreed upon (counter-trading, market-splitting, etc.). Many uncertainties therefore remain as to whether and in what form (i) the MIBEL will actually start on 30.06.2005 and, if so, (ii) whether it will prove to be effective enough to lead to an Iberian electricity market in the foreseeable future.
121. In their replies to the Statement of Objections, the parties argue that the termination of the PPAs “constituted the main necessary pre-condition to the establishment of the MIBEL. The parties would therefore submit that a significant step on this issue has been concluded and that further progress has now to be expected, in line with the high level of political understanding recorded in the October Agreement between Portugal and Spain”⁹². If it is clear that the termination of the PPAs is a necessary condition for further market integration (which has been taken account of in the Commission’s competitive analysis), the above-described findings of the Commission show nevertheless that this condition remains far from sufficient. These findings have not been disputed by the parties. On the contrary EDP states in its reply that “the parties have never claimed that an exhaustive regulatory convergence will have been achieved

⁹⁰ Minutes of meeting with REE, on 26.08.2004.

⁹¹ Acordo entre a República Portuguesa e o Reino de Espanha relativo à Constituição de um Mercado Ibérico da Energia Eléctrica., Santiago de Compostela , 1.10.2004.

⁹² EDP’s reply on 28.10.2004. p19.

on the starting date of MIBEL”⁹³. EDP also acknowledges that “the agreement [of 1 October 2004] does not specifically address all regulatory issues”.

122. It follows from all these elements that, under a prospective analysis of the markets concerned, it is not possible to consider, as required by the Commission’s Notice, that the regulatory barriers still existing between Portugal and Spain “have now been removed” and that, as a result, there is “a process of market integration that would, in the short term, lead to wider geographic markets”.

123. This conclusion is reinforced by the fact, explained in details below, that other structural barriers are also likely to remain in the near future, thereby impeding the effective establishment of an Iberian wholesale electricity market.

The projected level of interconnection capacity between Spain and Portugal is not likely to allow effective integration of both markets in the near future

124. The parties argue that the interconnection capacity between Spain and Portugal will be substantially increased through a combination of building new interconnection lines and upgrading existing ones.

125. For the years 2004 and 2005 a new interconnection facility between Alqueva and Balboa (in the Alentejo) is expected to start operations and the existing line between Lindoso and Cartelle (at the Galician border) will be reinforced. According to the parties, this will have the following effect on interconnection capacity.

Forecasts	By end of 2005	
Peak demand	9182 MW	
Interconnection capacity (Summer)	1250 MW	14%
Interconnection capacity (Winter)	1000-1225 MW	11-13%

Source: parties’ estimates

126. The parties claim a further increase of interconnection capacity for 2007/2008.

Forecasts	2007/2008	
Peak demand (MW), in 2007	9564	
Interconnection capacity (Summer)	1610-1980 MW	17-21%
Interconnection capacity (Winter)	1700-2080 MW	18-22%

Source: parties’ estimates

⁹³ EDP’s reply on 28.10.2004. p17.

127. The Commission asked the Portuguese regulator (ERSE) and the Portuguese electricity grid operator (REN) about their estimates of the interconnection level in the future. The capacity assumed by the Portuguese energy regulator, ERSE, (based on REN documents) in its reply to the Commission’s questionnaire is either at the lower end or significantly below the figures assumed by the parties: for 2005 ERSE states 1000 MW (parties 1000-1250 MW) and for 2007/2008 ERSE states 1500 MW (parties: 1610-2080 MW)⁹⁴. Finally, the Portuguese electricity grid operator provided the Commission on 07.10.2004 with the “*actual Commercial Interconnection Capacity that is different from the correspondent maximum technical values which are directly obtained from the load flow calculations*”⁹⁵. It confirms that the commercially available capacity to import electricity from Spain into Portugal will be in the range of 1440MW-1530MW in 2008.

Year	Portugal->Spain		Spain->Portugal	
	Summer	Winter	Summer	Winter
2005	800	1260	850	900
2006	1080	1440	1125	1080
2007	1260	1620	1350	1260
2008	1530	1890	1440	1530
				MW

Source: REN; October 2004

128. Furthermore, to put the parties’ own figures into perspective, three factors need to be considered: (i) the comparison of import capacity of countries which may be approaching more unified wholesale markets, such as the Nordic countries, (ii) the specificities in Portuguese electricity generation which make a high demand for imports from Spain likely, and (iii) views expressed by market participants.

Import capacities are significantly higher in more unified markets

129. First, the Draft Third benchmarking report on the implementation of the internal electricity and gas market gives the following figures for import capacity (not as a percentage of peak capacity but as a percentage of generation capacity)⁹⁶ :

- Denmark: 51%, Finland: 25%, Sweden : 29% ;

- Portugal : 8%, Spain : 5%.

130. These figures indicate that Portuguese interconnection capacity, even if it is, according to the parties, to be substantially increased from 2004 to 2006, will still be lagging behind the interconnection capacities between countries between which congestion is at a comparatively low level (in the Nordic countries) without having, as yet, led to the finding of wider than national wholesale markets.⁹⁷

⁹⁴ ERSE’s reply to the questionnaire of 28.7.2004, page 8. ERSE bases itself on figures by REN, citing the lower end of ranges.

⁹⁵ Mr.Santos’ (REN) email on 7.10.2004

⁹⁶ Figures are based on ETSO NTC winter 2003-2004. Third benchmarking report on the implementation of the internal electricity and gas market, DG TREN Draft Working Paper, Brussels, 1.3.2004, p.20

⁹⁷ It should be noted that in its decision Sydkraft/Graninge of 30.10.2003 (case COMP/M.3268, p. 26) the Commission found that Sweden was isolated from all other areas in the Nordpool area only 5,5% (2000) 0,0% (2001), 0,1% (2002), and 0,0% (Jan –Sept 2003) of the time. Isolation percentages between individual neighbouring territories and Sweden were somewhat higher but also generally low (eg. on average 7% between Sweden and Denmark East in the same period). Even though the Commission

Generation mixes in Spain and in Portugal are different and will remain so

131. Secondly, it can be expected that the strong dependence of the Portuguese electricity generation on hydro-generation will necessarily act as an even stronger driver for import demand (leading, however, to congestion rather than to price convergence) once Portuguese wholesale supply of electricity is further opened to competition as a consequence of the expected termination of PPAs. This is outlined in the following two paragraphs.
132. The parties estimate that about [40-50]*% of the total installed capacity in Portugal depends on meteorological conditions, mainly hydro power plants and wind energy.⁹⁸ While hydro-power generation in SEP accounted for only [10-20]*% of Portuguese annual generation in 2002, this percentage doubled in 2003 to [30-40]*%.⁹⁹ In the dry summer months, Portuguese hydro power production is generally much reduced and it is then when the demand for imported energy is highest. For example, in July 2002 EDP's CPPE hydro power plants were in operation only for [...] hours. One year later, in July 2003 these plants operated for [...] hours. In 2003 the hydro plant was in operation [...] times longer than in 2002. The same plants' operational time in January was [...] hours in 2002 and [...] hours in 2003, again a variation of around 400%.¹⁰⁰
133. The impact which this has on generation costs can be estimated by comparing the hydro plants with a close to zero marginal cost with the plants with the highest marginal cost in Portugal, fuel oil plants. In July 2002 the dual fuel oil/gas plant in Carregado operated for [...] hours whereas its operational time was only [...] hours in July 2003, a year with high hydro-electric resources. The same plant operated [...] hours in January 2002 but only [...] hours in the water-rich January 2003. It is clear that electricity in Portugal was produced much more cheaply in 2003 than in 2002. The pressure on imports into Portugal will come from a different Spanish generation portfolio with a much lower percentage of hydro power and a substantial amount of nuclear energy. Therefore it can be expected that, particularly in dry years, the imports from Spain into Portugal will substantially increase in periods of peak demand as electricity during those periods can be expected to be produced cheaper in Spain. Demand for interconnection capacity will rise accordingly. Similar flows of electricity will also keep arising in base load periods since base load in Spain is mainly covered by nuclear plants which have much lower marginal costs than the coal plants used in Portugal as base load.
134. In this respect, the parties argue in their replies to the statement of objections that "*the Portuguese and Spanish generation mix are rapidly converging thereby reducing the needed interconnection capacity for a fully integrated market*"¹⁰¹. This conclusion relies mainly on the assumptions of the parties that (i) new CCGTs will appear and

considered that the generation/wholesale market might be larger than Sweden, it left open the precise scope of the geographic market. See also the decision by the Danish Competition Authority in case Elsam/NESA. <http://www.ks.dk/konkurrence/afgoerelser/2004/R2403/elsam/> finding electricity wholesale markets no wider than Denmark.

⁹⁸ While the relative weight of hydro plants will slightly diminish in the next two years as not much new capacity will be added, the relative importance of wind power will increase as wind energy, next to CCGTs, will be the main source of additional capacity in Portugal. It can be expected that the exposure to meteorological variations will rather increase than decrease.

⁹⁹ Form CO, Annex 10 p.14

¹⁰⁰ Form CO Annex 13, p.163 f.

¹⁰¹ EDP's reply to the SO, on 28.10.2004, p.11.

replace the current fuel-oil plants in Portugal, (ii) the entry into force of the NAP¹⁰² provides for further incentives for switching to CCGTs in both countries and (iii) the share of nuclear energy will diminish following the interdiction to build new capacity. However, as explained below in detail, the Commission's findings indicate that, irrespective of the Portuguese and Spanish NAPs, new CCGTs (apart from TER and Turbogás) are unlikely to be launched at least until 2010. Nuclear power generation will progressively decrease but only on the long run: no change is expected at least until 2012¹⁰³. The Commission therefore does not share the parties' conclusion as to a "rapid convergence" of the generation mixes between Spain and Portugal.

Third parties' estimates of necessary interconnections are well above expected levels in 2008

135. Thirdly, it should be mentioned that three important market participants have estimated the interconnection capacity that would be necessary for the functioning of an Iberian wholesale market would be 2000 MW. This is a value which, by far, is not reached now, will not be reached by 2006, and is even very doubtful for 2008. It also needs to be taken into account that one of these respondents said that, in the long term (after 2012), 3000 MW would be needed. Another electricity player "considers that a level of interconnection between Portugal and Spain in the range of 25% of the peak consumption in Portugal is the minimum necessary to ensure a free flow of power between the two countries. According to the latter, this figure is a kind of "rule of thumb" that is generally accepted by the various electricity players."¹⁰⁴ Given that the peak demand is expected to be in the range of 9600MW¹⁰⁵ in 2008, a minimum level of 2400MW would be necessary.
136. These figures have been confirmed by the Spanish electricity system operator which "estimates that a level of interconnection of 30% of the Portuguese peak consumption may be enough to ensure that EDP cannot exercise market power in Portugal. REE and REN sought to forecast the level use of interconnectors in the coming years. It results there from that congestions are likely to keep occurring in the future despite the development of interconnection. This is explained by the fact that interconnection will remain limited (1440MW in summer, 1530MW in winter) and the demand is growing strongly. Congestions will happen even more often during dry years."¹⁰⁶
137. The parties nevertheless submit that statements in the Cambridge study support their view that the level of interconnections will shortly reach the necessary level¹⁰⁷ by referring to extracts in which it is stated that "for electricity, the plans to enhance the transmissions systems in both countries are well advanced with 4 separate initiatives to be completed in 2004/5 and an additional reinforcement to take place by 2007/8.... In the context of a system with maximum demand of 7GW, these enhancements appear to be sufficient"¹⁰⁸. However, the parties first fail to quote the Cambridge study insofar as it states afterwards that "until these developments are completed, interconnection is not sufficient with imports dominating the utilisation of the

¹⁰² NAP: National Allocation Plan of Carbon dioxide emissions

¹⁰³ REN/REE: "Previsión conjunta de la cobertura de la demanda – Periodo 2004 - 2012", December 2003.

¹⁰⁴ Minutes of a conference call on 25.08.2004

¹⁰⁵ "Previsión conjunta de la cobertura de la demanda de MIBEL », REN, REE, December 2003.

¹⁰⁶ Minutes of meeting with REE, on 26.08.2004.

¹⁰⁷ Paragraph 41 of the parties' reply to the Commission's article 6.(1)(c) decision.

¹⁰⁸ Paragraph 46 of the parties' reply to the Commission's article 6.(1)(c) decision quoting Cambridge Economic Policy Associates. April 2004. Page 29.

*interconnection. This means that EDP will effectively control market prices of electricity until that time*¹⁰⁹ In addition, according to recent data, it appears that the maximum demand forecast in 2008 will no longer be 7GW but 9.6GW¹¹⁰, that is almost 40% higher than the figure used by the Cambridge study. Furthermore, the parties fail to quote the conclusion of the Cambridge study on this part of the report which clearly states that: *“However, there is significant work needed to complete the commercial integration of the markets, and while the political will to complete the market may be present, and resolution of key issues may be completed by 20 January 2004, the implementation may take longer than planned”*¹¹¹. This is all the more true at present since, as explained above, many key issues remain to be solved before being implemented.

138. Apart from congestions between Spain and Portugal, it is also noteworthy that imports can be limited because of technical constraints within the national network. Thus, CNE underlines that *“congestions will keep occurring between Spain and Portugal and the two markets will be split a certain part of the time. Moreover, the quantities of electricity which can be imported in a certain area can also be reduced due to technical constraints in the domestic network, for example because of voltage control and the consumption of reactive power.”*¹¹²
139. These issues have also been confirmed by OMEL, the Spanish electricity market operator. According to OMEL and REE, due to technical constraints within the domestic network, it seems excluded to import into Portugal more than 2000MW of power: *“the planned increases in interconnection capacity are unlikely to alter the 2000MW [maximum interconnection] capacity level [between Spain and Portugal]. The reason has to do with the fact that within Portugal electricity flows mostly from North to South travelling long distances. Increased flows in the event of increased interconnection capacity would induce transmission instabilities leading to a voltage collapse. The only solution to this problem is for more power plants to be built in the South.”*¹¹³ According to OMEL representatives, 2000MW of interconnection is possibly below the level necessary to ensure that EDP does not enjoy considerable market power in Portugal, even in the event of a successful implementation of the MIBEL.
140. In their replies to the statement of objections, the parties dismiss these estimates (even those given by regulatory bodies) on the ground that *“it directly contradicts information submitted by other parties to the Commission”*. To this end, the parties provide the example of Gas Natural which stated that interconnection levels in the range of 10% of the peak demand would be enough to equalize the prices of the two countries. The Commission does not share the parties’ view that only Gas Natural's estimate is reliable for the following reasons: (i) all other estimates, including those provided by independent regulatory bodies, are quite consistent with each other and range from 2000MW to 3000MW; (ii) despite the fact that the level of interconnection specified by Gas Natural (namely 800MW) is already available, prices in Spain and in Portugal are still far from being equal or from being highly correlated and congestions keep occurring very often. In this part of their reply, the parties also quote Endesa's opinion. However, the latter also refers to a 2000MW necessary level of

¹⁰⁹ Cambridge Economic Policy Associates. April 2004. Page 29.

¹¹⁰ “Prevision conjunta de la cobertura de la demanda de MIBEL », REN, REE, December 2003.

¹¹¹ The date cited is linked to one of the dates for which the implementation of MIBEL was foreseen.

¹¹² Minutes of meeting with CNE, on 7.9.2004

¹¹³ Minutes of meeting with OMEL, 26.8.2004

interconnection. The Commission therefore considers that the reply given by the parties does not dismiss the Commission's findings.

Discussion on forecasts submitted by the parties

141. Lastly, the parties have provided¹¹⁴ arguments relating to the transfers of power between Portugal and Spain based on forecasts computed by REN and REE and published in a joint study “Previsión conjunta de la cobertura de la demanda – Periodo 2004- 2012” of December 2003. From REN/REE forecasts, they draw the conclusion that “*the interconnection capacity is sufficient for the expected import/export between the two systems and therefore to guarantee a minimum level of congestions*”¹¹⁵.
142. However, the Commission notes that, in order to reach this conclusion, the parties have renamed REN/REE graphs as “interconnection restriction forecasts”¹¹⁶ whereas this study only refers to average transit in the interconnections over monthly periods. The parties have also redacted the units of the graph, which would have indicated the level of power actually transferred in the interconnection as well as the level of interconnection expected by REN and REE in 2008: a Net Transfer Capacity between Portugal and Spain in 2008 in the range of 1400MW-1500MW.
143. In the replies to the statement of objections, the parties now submit that the graphs submitted to the Commission were copied from a slide presentation by REN and that they had no copy of the actual study from which these graphs originate. As regards the title of the slide, the parties explain that the slide presentation by REN did not contain an explicitly title and that, consequently, they made up a title in order “*to reflect what was considered to be the content of the graph*”¹¹⁷. This may explain why the parties considered that this graph referred to levels of congestions (and drew conclusions on this basis) while, in reality, it referred only to average imports. Lastly, the parties apologise for the redaction of the units from the graph (which would have also made it clear that the graph referred to imports and not to level of congestions) as it “*is the result of an unintentional mistake resulting from certain difficulties encountered when formatting the document*”¹¹⁸.
144. Apart from these problems identified by the Commission, it is worth noting that in the study from which these graphs have been extracted, REN/REE come to a conclusion quite different from that of the parties, namely: “*(i) in 2004 and 2006, the capacity of commercial exchanges will be used almost always in totality in the sense Spain-Portugal [i.e. imports into Portugal], in particular in case of dry regime; (ii) From 2008 onward, the capacity of commercial exchange will be used 100% only during the peak-periods of certain months, as a result of the strengthening of interconnection planned for 2006 and of a better balance between the variable production costs of the Portuguese and Spanish systems, in particular in peak hour*”¹¹⁹. The interconnection will therefore remain heavily congested at least till 2008 and the congestion will not dwindle to minimum levels even from 2008 onward. The peak periods of certain months cannot be regarded as minimal periods given the fact that electricity shortages

¹¹⁴ Document submitted on 27.9.2004

¹¹⁵ Document submitted on 27.9.2004, page 5.

¹¹⁶ Page 5 of the document submitted by the parties on 27.9.2004.

¹¹⁷ EDP's reply to the SO, 28.10.2004, p.14.

¹¹⁸ EDP's reply to the SO, 28.10.2004, p.14.

¹¹⁹ P. 53 of the above-mentioned study by REN/REE, published in December 2003.

even in comparatively short peak periods can, due to the inflexibility of demand, lead to very significant differences in market conditions.

145. Lastly, in the original study, REN/REE have actually modelised and simulated the average transit of commercial exchanges in the interconnections between Spain and Portugal on a monthly basis, for the years to come (2004, 2006, 2008, 2010 and 2012), and for three different hydrologic regimes (normal, wet and dry). This means that the graphs indicate average levels and absolutely not, contrary to what the parties seemed to imply, how often congestions will occur or, worse, whether congestions will occur at all.
146. Logically, the lower the transit in the interconnections will be as compared with the interconnection capacity, the less likely the congestions will occur. However, these data do not allow predictions to be made how often congestions will occur in the future: congestions can happen a significant part of the time (as it currently does) and the monthly average transit may still remain below the maximum interconnection level. Contrary to what the parties tend to imply, the fact that the average transit of a given month does not reach the maximum interconnection capacity can nevertheless mean that congestions occur. In the replies to the statement of objections, the parties explicitly accept this conclusion.
147. In the light of the above-described elements, it seems very likely that congestions between Spain and Portugal keep occurring a significant proportion of the time [...] ^{*120}.

EDP as the main electricity generator in Portugal has the ability to artificially reduce the interconnection level available for competitors

148. As OMEL puts it, “*The real problem, in any case, is that most of the Portuguese generation capacity is concentrated on the hands of a single player (EDP). In Spain, in contrast, both Endesa and Iberdrola are more dispersed making it more difficult to exercise unilateral market power in a specific region.*” ¹²¹ Indeed, according to several market participants and energy authorities, EDP can very easily increase the likelihood that congestions occur between Spain and Portugal, thus protecting its stronghold from the influence of Spanish competitors.
149. Thus, the Portuguese energy regulator explains that “*the insufficient level of interconnection and a congestion management based on a mechanism such as market splitting which create two areas of different prices, can lead EDP, given the size and the location of its installed capacity, to develop a strategy of participation in the market so as to exert market power and, consequently, influence in a decisive way the formation of the price of electricity in the price area corresponding to Portugal*” ¹²²
150. Diverse types of behaviours are possible. OMEL explains that EDP can offer electricity at a high price thus provoking significant imports into Portugal and the occurrence of congestions. Since the local demand in Portugal has to be matched by supply, EDP’s plants are going to be eventually dispatched but at a much higher price than the market price. Given the low elasticity of demand, the loss of generation due to imports (up to create a congestion) is largely covered by the higher prices that can be charged when congestions occur, making such behaviour profitable. As explained by

¹²⁰ [...]

¹²¹ Minutes of meeting with OMEL, 26.8.2004

¹²² ERSE’ reply of 6.8.2004

OMEL: “ three pre-conditions are required to provoke congestions: (i) to be present at both sides of the bottleneck; (ii) to be dominant on one of the two sides and (iii) the existence of constrained inter-connection capacity. These conditions are met as regards EDP. It operates at both sides of the Portuguese-Spanish border, through its ownership of Hidrocantábrico. It has an almost monopoly position in Portugal and of course interconnection capacity is limited. [...]”¹²³ To better understand this result, note that market share does not determine the ability to exercise market power but rather the geographical distribution of generation plants. A firm will have considerable market power if all its generation assets are concentrated within a certain region, quite independently of its market share in the overall market.”¹²³

151. According to CNE, the Spanish regulator: “In the context of the MIBEL, this ability is unaltered and would lead, technically speaking, to market splitting (if such a congestion management rule is retained). In the case of EDP, a part of the imports triggered by such behaviour could be provided by Hidrocantábrico, making such behaviour even more profitable.”¹²⁴
152. In their replies to the statement of objections, the parties consider that “both the opinion of OMEL [...]”¹²⁵ and the response of ERSE [...]”¹²⁵ are purely hypothetical in nature and not based on any past behaviour”¹²⁵. However, the ability to influence the level of congestions referred to by ERSE and OMEL (which are regulatory bodies) is based on the Spanish experience. The reason why such behaviour has not already been observed in Portugal is merely due to the fact that EDP is not yet allowed to choose which power plants should be dispatched and at which price (this role was fulfilled by REN). Once PPAs will be terminated, EDP will take over the dispatching role of REN and will decide on the price of the power it generates.
153. In light of the limited level of interconnections in the future and of the influence that EDP can have on the level of congestions, it seems therefore reasonably likely that congestions will keep occurring a large part of the time, thus leading to different prices between Portugal and Spain.

Frequent congestions create different competition conditions between Spain and Portugal on a permanent basis.

154. In the context of an Iberian pool (such as the one foreseen in MIBEL) where congestions between the two countries are managed using the “market splitting” method, congestions may lead to the creation of different price areas. In this framework, market prices in Spain and Portugal will thus be different all the more often as congestions are frequent. As highlighted by the parties, “temporary bottlenecks clearly may prevent the existence of a permanent single price area”¹²⁶. This is also underlined by the Portuguese energy regulator, ERSE: “as long as the capacity of interconnection will not be sufficient to fully integrate the two [electricity] systems, one will have to put special attention on the market power which exists in each area of price”¹²⁷

¹²³ Minutes of meeting with OMEL, 26.8.2004

¹²⁴ Minutes of meeting with CNE, on 7.9.2004

¹²⁵ EDP's reply to the SO, 28.10.2004, p.14

¹²⁶ Para 53 of the parties' reply to the 6(1)c decision.

¹²⁷ “enquanto a capacidade de interligação não seja suficiente para integrar completamente os dois sistemas, deve prestar-se especial atenção ao poder de mercado existente em cada zona de preços” in “comentários

155. However, the market investigation carried out by the Commission has shown that the mere fact that congestions happen often creates different competition conditions in Portugal, as compared with Spain also in times outside these congestions. Indeed, each time a congestion occurs, electricity players who planned to import electricity can finally import only a fraction thereof and have to find the missing volume of power in Portugal at short notice. For the time being, power at short notice can be purchased from REN but with an extra-cost in the range of 36EUR/MWh (set by the regulator). Since the average price of electricity bought in Spain is in the same range (and prices in Spain are often lower than in Portugal), power in time of congestion can cost importers twice the price they normally pay. This high additional cost and the unpredictability of congestions make importers incur much higher market risks when selling power in Portugal than in Spain.
156. Once PPAs and REN's role as single buyer are terminated, it is likely that importers will have to enter into back-up contracts with local generators who may be able to supply them with additional electricity at short notice. It is therefore possible that importers will have to rely on EDP since it operates the majority of the installed capacity in Portugal, such increasing the cost of supply in case of congestions. This applies not only to importers buying electricity on the Spanish pool but also to bilateral contracts as explained by the Spanish grid operator, REE: *"In 2003, ERSE and CNE published a theoretical model for the MIBEL, in which bilateral contracts accounted for most of the exchanges of power and the pool was used only for adjustments. If this is the case, it means that the current organisation in Spain has to be deeply revised as the bilateral contracts are the exception nowadays. It also implies that the parties to a bilateral agreement will have to book capacity too. They will run a risk when this includes the interconnection between Portugal and Spain and will have to find local back-ups."*¹²⁸
157. The permanent market risk due frequent congestions can be seen as one of the reasons why Spanish electricity players are contemplating building CCGTs in Portugal. In particular, Iberdrola explained that *"The Portuguese electricity market will remain more or less isolated in the coming years. Hence, Iberdrola needs to be sure it has generation in Portugal in particular to balance its needs and master its costs of supply."*¹²⁹ The importance of having generation capacities in Portugal to be a competitive player on the long run is also highlighted [...] ¹³⁰
158. The findings of the Commission described above (at paragraphs 154-157) relating to the permanent impact of the frequent congestions on the competition conditions in Portugal is not disputed by the parties in their replies to the statement of objections.
159. In light of all elements described above, it is therefore far from certain, if not excluded, that the necessary interconnection capacity between Spain and Portugal will be in place even by 2007/2008. For the period immediately after termination of the PPAs, i.e. for 2005-2006, the attainment of the necessary interconnection capacity can, on the basis of the information available, be excluded. Even after termination of the PPAs, the relevant geographic market for the wholesale of electricity will therefore remain national in scope.

da CNE/ERSE/erse às soluções acordadas sobre o mercado ibérico da electricidade", 19.12.2003, by ERSE and CNE

¹²⁸ Minutes of meeting with REE, on 26.08.2004.

¹²⁹ Minutes of meeting with Iberdrola on 08.09.2004

¹³⁰ [...]

Conclusion on the geographic dimension of the wholesale electricity market on the basis of abovementioned elements

160. On the basis of all elements described above on the regulatory barriers, the interconnection capacity and the congestions level, the Commission has reached the conclusion that the electricity wholesale market will remain national in scope in the foreseeable future.

Competitive conditions between Spain and Portugal are likely to remain significantly different even after the launch of the MIBEL

161. In addition to the elements mentioned above, it should be pointed out that it is very doubtful that market conditions, and therefore prices, will become homogeneous between Spain and Portugal in the foreseeable future. This is mainly due to the problems relating to the CO₂ emission national allocation plans and to the compensation scheme for stranded costs as will be explained in the following paragraphs.
162. The difference in the competitive conditions between the two countries determined by these factors is also sufficient in itself to conclude that the electricity wholesale market will remain national in scope in the foreseeable future.

CO₂ emission national allocation plans (NAP) may have significant and different impacts on the national merit orders

163. The generation portfolios and the “merit order” structure in both countries show significant differences (also due to the significant amount of nuclear energy in Spain) which may cause uneven incentives to progress to the full completion of an Iberian market.
164. Other factors may equally influence the degree to which the Spanish and the Portuguese wholesale market can converge: among those are the allocation plans of CO₂ allowances. These plans, submitted this year, allocate free CO₂ emission allowances to power producers. As this allocation is proposed by governments and approved by the Commission on a national basis, it may impact on the price of technologies that heavily emit CO₂ such as coal-fired power plants in a different manner for each country.
165. In that respect, OMEL thus states that “*CTCs and CO₂ allowances: very critical as indicated, if both issues are not harmonised it will be very difficult that MIBEL starts since the distortions could be enormous*”¹³¹
166. The likely impact of CO₂ allowances on pricing has been acknowledged by the parties themselves when underlining that [...]”¹³²
167. In its internal documents, EDP further states that [...]”¹³³.
168. It is also acknowledged by EDP that such allowances may lead to different competitive conditions in Spain and Portugal in the following terms: [...]”¹³⁴.

¹³¹ Slide presentation by OMEL on 26.8.2004.

¹³² [...]

¹³³ [...]

¹³⁴ Acta 5/2004, Implicações da directiva de comercio de emissões de gases com efeito de estufa, apresentação ao secretario de estado adjunto do Ministro da Economia, dated 28.1.2004, and submitted by EDP further to Q.6 dossier 6 (C) of the Art. 11 letter of 14.7.2004.

169. In another presentation, EDP has given indications as to the possible quantitative impact of CO₂ allowances on the electricity prices. EDP assesses this impact according to different assumptions of the price of one ton of CO₂ emissions. In the middle of the range of prices mentioned in this slide, EDP has in particular highlighted one price of CO₂, namely [...] EUR/ton, and provided specific estimates of the impact taking this value as underlying assumption. Thus, according to EDP and under the assumptions which seem the most likely to EDP, the CO₂ emission trading scheme ("ETS") would lead to increases of electricity prices in Portugal ranging from [10-20]*% for low-voltage customers to [30-40]*% for very-high-voltage customers. At the wholesale level, EDP estimates that as a result of ETS prices will increase by as much as [30-40]*%. Such increases are far from being insignificant and can greatly impact on the merit order in Portugal as compared with the Spanish one.
170. The significant and possibly different impact of the Portuguese CO₂ emission NAP on the prices in Portugal as compared with those in Spain has not been disputed by the parties.

Compensation scheme will have a significant impact on prices

171. As explained above, PPAs tying up generation capacity in Portugal with the current single buyer, REN, will be terminated in order for the liberalisation of the Portuguese electricity market to proceed. As these contracts have been guaranteeing the prices and conditions at which generators have been selling the electricity produced to REN, a compensation scheme (CMECs: *Custos para a Manutenção do Equilíbrio Contractual*) will shortly be introduced to compensate for the possible loss, i.e. for the difference between the observed prices on the market and prices guaranteed so far by the PPAs. A total amount of maximum compensations for the period is attributed to each player. Only power plants bound by PPAs and launched before liberalisation was decided are concerned. The Portuguese scheme is expected to start being applied later this year or in 2005. A similar scheme (CTCs: Competition Transition Costs) has been introduced in Spain in the years 1999/2000.
172. Most market participants have underlined that the compensation scheme in Spain (CTCs) has had a very significant impact on prices in Spain. The Portuguese CMECs are also expected to have a strong impact on electricity pricing. Indeed, since generators covered by this scheme are compensated for the difference between the old contractual price and the price on the market, they can offer prices on the market which are decoupled from the underlying generation costs to a significant extent and use this price for strategic purposes. CTCs or CMECs act directly on the marginal cost proposed by the players. According to the Spanish market operator, OMEL: *"It is important to take into account the way in which [PPAs] are broken because the marginal cost in Portugal will depend a lot on this"*. This is also reported in the Study¹³⁵ commissioned by the Portuguese competition Authority: *"It should, however, also be noted that the combination of the PPAs and CTCs have a significant impact on the market participants, and the formation of prices in the liberalised market, and we would expect this to continue, unless reformed."*
173. The effects stemming from the CTCs are described by the Spanish electric grid operator, REE, as follows: *"This scheme protects the incumbent against potential entrants since the incumbent can use it to lower prices without losing money. In Spain, new entrants burning gas to produce electricity, seems to have been losing money*

¹³⁵ Cambridge study, April 2004, page 30.

when developing in the electricity market. The price at which it has to sell electricity hardly covers the price of gas, based on the international price of gas”.

174. The importance of this issue is also underlined by ERSE, the Portuguese regulator, in the following terms: *“The full implementation of the Internal Market of Electricity depends on the answer to be provided to some crucial questions. These questions mainly regard the mechanism of recovery of the stranded costs, the exercise of the market power by market agents that have hegemonic market shares (in the overall market or in parts of it), as well as on how the restrictions in the capacity of transport of electricity at the level of interconnection will be solved. In fact, these questions when considered per se or together are obstacles to the existence of an efficient and competitive market of electric energy.”*¹³⁶

Even though compensation schemes are similar in principles, their implementation leads to strong differences in the pricing behaviours in each country

175. The Portuguese CMECs which may be applied soon and the Spanish CTCs share the same ground principles. However there are likely to produce very different effects, respectively in Portugal and in Spain. Indeed, the possible strategic behaviours triggered by these compensation schemes are dependent on the level of compensation allocated to each player on the domestic market as well as on the evolution of the individual amounts available. Thus, a player whose available amount is limited (such as Iberdrola) will not act the same way as a player who has still a lot of compensations ahead (such as Endesa). As explained by REE: *“incumbents have different incentives depending on their share in the CTCs (If their share in the CTCs is higher than their current generation share in the market they profit from lower prices. Other companies whose current generation market share is higher than their CTC share lose in the same low price scenario.)”*¹³⁷
176. In particular, the initial allocation is specific to the country and depends on several factors (level of generation of the plants covered, degree of amortization, etc.). On the contrary, how this amount is consumed depends on the bidding strategy of the player and on the evolution of its actual market share. As a result, the difference in current available individual compensation amounts, because of past evolutions or different initial allocations, may make players follow different strategies and offer very different prices.
177. In that respect, OMEL underlines the differences between the Spanish and Portuguese regimes in the following terms: *“it appears that the stranded costs will be compensated at a higher price in Portugal than it was the case in Spain (€3.6 kw/h or 6pts). Also there is a different timing. In Spain they will end in 2007 and 55% of CTCs have already been paid. Finally the coverage is also much larger in Portugal, with up to a 90% of the energy. The different level of compensation which in the next years will get the Portuguese and the Spanish companies and the fact that the Portuguese compensation scheme will continue after the end of the Spanish one create a clear disincentive for the Spanish authorities to effectively launch the MIBEL.”*¹³⁸
178. The issues of the different timing between the two schemes and the different allocation due to a different structure of the market are also highlighted by REE: *“In addition, in Spain there are two large companies which have received these compensations. On the*

¹³⁶ ERSE’s reply of 6.8.2004

¹³⁷ Minutes of meeting with REE, on 26.8.2004.

¹³⁸ Minutes of meeting with OMEL, 26.8.2004

*contrary, in Portugal, EDP will be the one to receive most of the compensation. CMECs will make EDP much stronger than CTCs vis-à-vis Endesa and Iberdrola. The funds are also different and will unroll in a different time period: the CTCs are declining in Spain while the CMECs have not started in Portugal and will unroll over ten years. As a result, even if the principles of the scheme are similar, it will trigger very different behaviours between Spain and Portugal which will further increase the gap between Spanish and Portuguese players (“the pocket is different”).”*¹³⁹

The distortions created by different conditions of costs and pricing behaviours may have strong detrimental effects on the development of MIBEL and help maintaining two distinct electricity markets.

179. Since these schemes tend to decouple the prices offered on the market from the underlying generation costs and have different and significant impacts on the pricing strategies on each side of the border, it is far from excluded that significant distortions in the prices offered on the pool will exist once MIBEL is ultimately launched. As REE puts it: “[t]he price distortion introduced by this scheme may significantly alter the working of the MIBEL.”¹⁴⁰
180. This has been confirmed by some market participants. Iberdrola thus considers that “CTCs in Spain have created huge distortions in the electricity market. Iberdrola hopes a better system will be applied in Portugal. Iberdrola considers that the Iberian pool cannot go ahead if a similar system were to be applied in Portugal. MIBEL would be a trading system between two distorted markets.”¹⁴¹
181. Such possible effects have also been confirmed by regulators. In that respect, CNE, the Spanish regulator, underlines that “*The compensation mechanisms chosen by the Spanish government bring some distortions of prices. This has been highlighted jointly by CNE and ERSE in a joint report. If a compensation scheme similar to that of Spain is chosen in Portugal, it may act as a high barrier to entry for non-Portuguese players and have a significant impact on the effective working of the future MIBEL*”¹⁴²
182. ERSE and CNE foresee that the future MIBEL should rely on three types of market: the spot market (OMI-E), the futures market (OMI-P) and bilateral contracts. According to the regulators, bilateral contracts will represent the bulk of the transactions. The spot and futures market aim to provide electricity on a spot basis or secure energy for a remote term, and generate common prices that can be used as references in the bilateral contracts. If these prices are distorted and do not reflect real conditions faced by the market players, it is likely that little energy will be traded on these markets and that bilateral contracts will not refer to these prices any longer. As explained by REE, the MIBEL indeed depends on the credibility of prices on pool: “*The price of the pool will be used as a reference for the bilateral contracts (like the price of oil on international markets whilst the transaction on these markets accounts only for 4% of the overall transaction). It has to give credible signals. If the price on the pool is distorted for several reasons and not credible any more, it is likely that players stop using it, thus killing the Mibel.*”¹⁴³ As a result, despite the launching of the MIBEL, electricity prices would still be established depending on the local

¹³⁹ Minutes of meeting with REE, on 26.8.2004.

¹⁴⁰ Minutes of meeting with REE, on 26.8.2004.

¹⁴¹ Minutes of meeting with Iberdrola on 8.9.2004

¹⁴² Minutes of meeting with CNE, on 7.9.2004

¹⁴³ Minutes of meeting with REE, on 26.8.2004.

conditions and would maintain Spain and Portugal as the two distinct electricity markets.

Parties' position in their replies to the statement of objections

183. In their replies to the statement of objections, the parties argue that the compensation scheme expected in Portugal (CMECs) and that of Spain (CTCs) are different and therefore that no conclusion can be drawn for Portugal from the Spanish experience of CTCs.
184. Firstly, it is worth noting that the parties do not dispute the significant impact on prices that CTCs have had in Spain (see paragraphs 172 - 174), as described in the statement of objections.
185. Secondly, even though there are some differences between the two schemes (as explained by the parties), the latter both share the same basic principles which explain their influence on market prices. They both rely on a mechanism whereby the compensations granted to the suppliers are adapted *a posteriori* based in particular on the market price witnessed during the period. As a result, large incumbents who can influence prices, such as EDP, are in a position to alter their prices on the market so as to achieve strategic goals (such raising barriers to entry) in a profitable way. This mechanism as well as the impact thereof has been identified¹⁴⁴ by the Spanish and Portuguese regulators, ERSE and CNE, also with respect to Portugal, despite the formal differences between the two schemes. As a result, the Commission considers that the experience of the Spanish CTCs can be used as a useful indication of what can be expected in Portugal, as suggested by the regulators, for the assessment of the present case.

Conclusion

186. For all the reasons mentioned above, the Commission's in-depth investigation therefore confirms that the relevant market for the wholesale of electricity is national in scope and that high uncertainties remain as to the reality of an Iberian electricity market in the near future for the purpose of the assessment of the present operation.

(c) Ancillary services

187. Ancillary services are even more dependent on immediate availability within a certain balancing/regulating area than general wholesales. They are therefore even more vulnerable to congestions and even more dependent on exactly harmonised market rules. The above therefore *a fortiori* applies to ancillary services. The recent agreement between the Portuguese and Spanish governments confirms that regulating and balancing rules are to be set up on a national level.¹⁴⁵ The market or markets for ancillary services will therefore remain national.

¹⁴⁴ Comentários da CNE/ERSE às soluções acordadas sobre o mercado ibérico da electricidade. 19.12.2003.

¹⁴⁵ Acordo entre a República Portuguesa e o Reino de Espanha relativo à Constituição de um Mercado Ibérico da Energia Eléctrica., Santiago de Compostela , 1.10.2004., Articles 6 and 7.

(d) Retail markets

188. The parties do not claim that electricity retail markets will become wider than national in the foreseeable future. The Commission concurs with this assumption. Conditions for competition in the retail area will remain substantially different between Spain and Portugal. Indeed a local presence is required for all retail activities, whether to small or large customers. Issues to be resolved for market entry at a national level, apart from national presence, include brand recognition, marketing, customer service, metering and billing.
189. There is no reason to consider smaller than national markets. Even now EDP, through EDPD, has integrated its retail sales business from a formerly local level to a national level. After liberalisation this process will not be reversed and retail competition will take place at a national level even for household customers.

C. Relevant Natural Gas markets

1. The legal and factual framework

(a) *Description of the current situation of natural gas supply in Portugal*

The Maghreb international pipeline

190. Natural Gas was introduced in Portugal in 1997 after the construction of the Maghreb-Europe pipeline, which transports the natural gas of Algerian origin from the Algerian-Moroccan border to the Iberian Peninsula. A branch of that pipeline enters into Portugal at Campo Maior (in central Portugal, at the border with Spain) and crosses the Portuguese territory up to the Spanish–Portuguese northern border (Valença). This pipeline was jointly achieved by the Spanish undertaking Enagás, today "transmission system operator ("TSO"), and GDP's subsidiary Transgás. Each company holds various stakes and transport rights depending on the section of the pipeline. For the imports of natural gas through this pipeline, Transgás signed in 1993 a long term take-or-pay ("TOP") agreement with the Algerian company Sonatrach¹⁴⁶.
191. The yearly transmission capacity of this pipeline at the entry point into Portugal (Campo Maior) is 3,679 bcm; the hourly maximum capacity is 420.000 m³.¹⁴⁷ The transportation rights at the entry point into Portugal are held by Transgás and Enagas.
192. The capacity of the import pipeline at Campo Maior is reserved through long-term contracts as follows:¹⁴⁸

	in m ³ /h	In bcm/year	% of total
Enagas booked (only for transit to Galicia, NW Spain)	[...]*	[...]*	[10-20]*%
Transgás booked	[...]*	[...]*	[80-90]*%
Available for either party	[...]*	[...]*	[0-10]*%

193. The capacity "Available for either party" can be requested by either Enagás or Transgás. In case of conflicting requests rights are shared on a *pro rata* basis (Transgás [80-90]*%; Enagas [10-20]*%). Enagás uses the capacity it holds to supply gas to

¹⁴⁶ The agreement entered will expire in [...].

¹⁴⁷ In this communication quantities will be stated in bcm (billion cubic meters), Mm³ (million cubic meters) and m³ (cubic meters). 3,679 means three point six seven nine; 400.000 means four hundred thousand.

¹⁴⁸ See ENI's reply to question 2 of the Commission's questionnaire of 15 September 2004; Eni's reply to question 5 of the Commission's request for information of August 19, 2004; Reply to question 51 of the Commission's request for information of 4 June 2004. It should be noted that the capacity booked by Transgás exceeds the volume it sources under its contract with Sonatrach, [...]The maximum firm capacity at the Campo Maior entry point from the Sonatrach Contract was [...]. (Reply to question 18 of the Commission's request for information of 4 June 2004.) This extra (annual) flexibility allowed Transgás in 2003 to import extra quantities through use of Enagas' Huelva terminal for re-gasification of LNG volumes.

Galicia, through Portugal. Enagás is contractually not allowed to use this capacity to sell import gas into Portugal.

The Sinès LNG terminal

194. A liquid natural gas (“LNG”) terminal and re-gasification plant started operating in 2004 in Sinès. The maximum annual capacity of this terminal is 5,256 bcm. The hourly maximum send-out flow capacity is 600.000 m³¹⁴⁹. The terminal is owned and operated by Transgás (GDP) which holds all capacity rights.
195. In parallel to the construction of the LNG terminal, Transgás [...] ¹⁵⁰. The situation of the imports of natural gas in Portugal is illustrated by the following table:

Contracts (in bcm)	2003	2004	2005	2006	2007
Sonatrach	[...]*	[...]*	[...]*	[...]*	[...]*
Nigeria	[...]*	[...]*	[...]*	[...]*	[...]*
Shell	[...]*	[...]*	[...]*	[...]*	[...]*
TOTAL	[...]*	[...]*	[...]*	[...]*	[...]*

Imports of natural gas 2003-2007(Average contracted quantity). Source: Transgás

196. The following capacity is reserved in the LNG terminal:

<i>In bcm</i>	2006	2007
LNG entry capacity Sinès	5.256	5256
Transgás booked	[...]*	[...]* ¹⁵¹

[]* ¹⁵²

Capacity booked so far in the LNG terminal

Distribution and supply

197. Natural gas is transported in the Portuguese territory through a high pressure¹⁵³ network, which is currently owned by Transgás but should to be unbundled and transferred to REN.¹⁵⁴ An underground storage facility is currently being built in Carriço by Transgás.
198. For most end-customers, the distribution and supply of natural gas is achieved through medium and low pressure¹⁵⁵ networks by six local distribution companies (“LDCs”), which operate in exclusive concession areas. Currently, EDP recently acquired joint

¹⁴⁹ This capacity can be increased only at the expense of its availability.

¹⁵⁰ This agreement starts in [...] with a duration of [...].

¹⁵¹ It should be noted, that, at a very late stage of the procedure (explanatory memorandum of 26.11.2004), ENI specified that the usage factor of the terminal ranges from [...] to [...] and that, therefore, the capacity available for third parties would be lower. Depending on this coefficient, the capacity available will range from below [...] bcm to [...]bcm, only, instead of 1.9 bcm. As a result, GDP would book from [...] Mcm to [...]Mcm, corresponding to [70%-80%] of the overall capacity of the terminal.

¹⁵² [...]

¹⁵³ Over 20 bar.

¹⁵⁴ This transfer is subject to the approval of the Portuguese competition authority. It will happen within a maximum of 19 and half months after completion of the present transaction.

¹⁵⁵ Respectively between 4 and 20 bar and below 4 bar.

control of Portgás which is the only LDC currently not controlled by GDP.¹⁵⁶ It is planned to sell GDP's participation in the two, by far, smallest LDCs, Beirágás and Tagusgás, to Iberdrola.

199. Large industrial customers (i.e. those consuming more than 2Mm³/y, "LICs"), LDCs and gas-based power plants are supplied directly by the importer, Transgás. In areas not connected with the distribution network natural gas is distributed through autonomous networks ("UADs") supplied by lorries.

200. The situation of the distribution of natural gas in Portugal is illustrated by the following table:

Company	GDP's share	Clients (thousand)	Sales Volume (Mm ³)	% Sales Volume	Primary network (Km)	Distribution network (Km)
Portgás	[40-50]*%	[100-150]*	[150-200]*	[20-30]*%	263	1,759
Lusitaniagás	[80-90]*%	[100-150]*	[100-150]*	[20-30]*%	233	2,201
Lisboagás	[90-100]*%	[400-500]*	[150-200]*	[30-40]*%	77	2,944
Setgás	[30-40]*%	[50-100]*	[40-50]*	[0-10]*%	95	1,015
Beirágás	[50-60]*%	[10-20]*	[0-10]*	[0-10]*%	36	225
Tagusgás	[40-50]*%	[0-10]*	[10-20]*	[0-10]*%	122	215
UAD's ¹⁵⁷	Duriense, [70-80]*% Others, [90-100]*%	[0-10]*	[0-10]*	[0-10]*%		174
TOTAL		[590-960]*	[450-690]*	100%	826	8,532

Distribution key indicators. Source: GDP Annual Report 2003

201. The Portuguese natural gas sector has grown considerably over the last years. In a first phase, natural gas was mainly used for power production through CCGTs, but recently its consumption increased significantly also in other sectors. The evolution and the structure of the Portuguese gas consumption for customer groups is illustrated by the following table:

¹⁵⁶ Five of these companies (Lisboagás, Lusitaniagás, Setgás, Beirágás and Tagusgás) are controlled by GDP. In Portgás, EDP has recently obtained authorisation for its acquisition of joint control (authorisation of the Portuguese antitrust authority on 20.09.2004).

¹⁵⁷ Duriensegás, Paxgás, Medigás, and Dianagás.

	1997	1998	1999	2000	2001	2002	2003	2001/2003
Power generators	27	402	1,428	1,175	1,098	1,383 158	1,125	+1.2%
LDCs	22	123	218	334	437	500	560	+13.3%
Large industrials (>2 Mm ³)	47	242	493	735	951	1,122	1,211	+12.9%
Total	95	767	2,138	2,244	2,486	3,006	2,896	+7.9%

Evolution and structure of gas consumption in Portugal (expressed in Mm³). Source: GDP

(b) The opening of the natural gas sector

202. As an “emergent market”, Portugal was not subject to the liberalisation provisions laid down by Directive 98/30/EC concerning common rules for the internal market in natural gas (the “First Gas Directive”)¹⁵⁹. Under Directive 2003/55/EC (the “Second Gas Directive”)¹⁶⁰ - which repealed, as of July 2004, the first gas directive - Portugal continues to qualify as an “emergent market” and benefits, *inter alia*, of a derogation from the opening calendar set out by this Community act¹⁶¹. As a result of this derogation, it is only as from 2007 that the definition of eligible customers shall result in an opening of the market equal to at least 33% of the total annual gas consumption of the national gas market. All non-household customers shall become eligible at the latest in 2009, and all households at the latest in 2010¹⁶². Hence, according to the directive, CCGTs and LICs will be liberalised, respectively, by 2007 and 2009. LDCs will be liberalised at the latest in 2009.
203. Notwithstanding this derogation, in 2003 the Portuguese Government approved two Resolutions¹⁶³ in order to anticipate the opening of the natural gas sector. These Resolutions stipulated, in particular, that the electricity generators with a presence in Portugal would become eligible natural gas customers from 1 July 2004 onwards. The adoption of the relevant legal provisions to implement this anticipated opening of the gas supply to power producers and to establish the correlated rules on third party access (“TPA”) to the high pressure gas network and the LNG terminal has now been postponed to 2005.

¹⁵⁸ The year 2002 was a dry year therefore inducing a higher utilisation rate of CCGT plants to compensate for the lack of hydro-power. This illustrates the need for flexibility in contracted quantities.

¹⁵⁹ Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 (JO L 204, page 1). See in particular Article 2(24), which specifies that “emergent market means a Member State in which the first commercial supply of its first long-term natural gas supply contract was made not more than 10 years earlier”, and Article 26(2) which provides a specific derogation for the “emergent markets”.

¹⁶⁰ Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC (OJ L 176, page 57).

¹⁶¹ Article 23(1) of the directive establishes in particular that “Member States shall ensure that the eligible customers are: ... (b) from 1 July 2004, at the latest, all non-household customers; (c) from 1 July 2007, all customers”.

¹⁶² See Articles 2(31) and 28(3) of the second gas directive.

¹⁶³ Resolutions of the Council of Ministers 63/2003 of 3 March 2003 and 68/2003 of 10 May 2003.

204. The Second Gas Directive provides that the supply and distribution functions shall be legally unbundled. Therefore, by 2007, the six LDCs shall be legally split between distribution (i.e. transport via low and medium pressure pipelines of gas) and the supply of gas to eligible end-customers¹⁶⁴.
205. LDCs currently have long-term gas contracts with Transgás. Once LDCs (or more precisely, the supplying companies stemming from their unbundling) will become eligible customers, their contracts with GDP/Transgás could either come to an end – according to [...] or, at least, be deeply reviewed in view of the new regulatory framework. Once eligible customers, LDCs may also source a part of their needs from other gas companies depending on the flexibility offered by their current supply contracts.

2. Product markets in Natural Gas

(a) *The parties' view*

206. In their answer to the 6(1)(c) decision the parties contested to the Commission to have wrongly considered “that the notified concentration will affect four natural gas product markets: (i) supply of gas to power producers; (ii) supply of gas to LDCs; (iii) supply of gas to large industrial customers; and (iv) retail supply of gas to small industrial, commercial and household customers”.
207. In this regard, the parties observed in the first place that “three of these four markets are not yet liberalized and that the Commission, in its previous decisions, often stated that the relevant product market must normally be viewed in the context of the opened segment of the market”. In line with its previous practice, the Commission should therefore only assess the impact of the concentration on “the recently liberalized (as of July 2004) market for the supply of gas to power producers”.
208. In the second place, the parties claim that, even if the Commission extends its evaluation also to markets that have not yet been liberalized, it should not assess the impact of the concentration in the four abovementioned markets, but should consider together the first three as part of a single, wider wholesale market. In other words, the Commission should just distinguish, on the one side, the market for “*wholesale supply of natural gas to all large customers (power producers, LDCs and large industrial customers)*” (also defined by the parties as “*non-retail customers*”) and, on the other side, the market for “*retail supply of gas to small industrial, commercial and household customers*”.
209. In their Response to the Commission’s Statement of Objections (“The parties’ Response”) the parties have further commented on these aspects which will be dealt with in the appropriate places below. The Commission merely notes at this point that also in the parties’ Response the fact that the supply of natural gas to small industrial, commercial and household customers constitutes a market separate from the supply of natural gas to other, larger, customers has not been contested by the parties and therefore constitutes common ground between the parties and the Commission.

¹⁶⁴ However, Portugal could possibly apply Art. 13, paragraph 2 *in fine*, of the Second Gas Directive and not to require the legal unbundling of distributors serving less than 100 000 connected customers, i.e. Setgas, Beiragas and Tagusgas.

(b) *The assessment of the impact of the concentration on markets not yet open to competition*

210. The Commission does not agree with the parties that in the present case it should not assess the impact of the concentration on markets not yet open to competition, but should limit its analysis to “*the recently liberalized (as of July 2004) market for the supply of gas to power producers*”.
211. In this regard, it should be recalled that as Portugal benefits of a derogation from the provisions of the Second Gas Directive on the market opening, for the time being, all the gas markets in Portugal are in a situation of legal monopoly. In particular, the supply of gas to power producers, which in the Portuguese Government’s intentions should have been opened to competition as of July 2004, is still reserved to Transgás and, according to the new plans, should be opened in the course of 2005.
212. In this situation, if it was true that the Commission can only regard the markets already opened to competition, the consequence would be that the Commission could not at all assess the impact of the notified concentration on the gas markets.
213. This would be, however, a clearly inappropriate conclusion, which would impede the Commission to evaluate the foreseeable competitive effects of the concentration on markets which, pursuant to the Second Gas Directive, have to be opened to competition in the next years following a clear and binding calendar. It is evident on the contrary that the Commission has a duty to evaluate if the notified concentration creates structural changes in the markets which will significantly impede the introduction of effective competition in the timeframe established by community law.
214. The Commission therefore will assess the foreseeable effects of the proposed concentration on the different gas markets, taking into account the timing for their opening to competition.

(c) *Commission’s view on the different product markets*

215. The parties have submitted that “once also the supply of natural gas to LDCs and large industrial customers will be liberalized, natural gas suppliers will compete with each other for all types of large, i.e. non-retail, customers”. Irrespective of whether “non-retail” customers (that is, according to the parties, CCGTs, LDCs and LICs) constitute one and the same market or three distinct markets, the Commission agrees that they are distinct from the “retail customers”, namely the small industrial, commercial and domestic customers, which are currently supplied by LDCs.
216. This distinction has indeed been confirmed by the investigation which showed that these customers are very different in terms of consumption, margins, tariffs and prices, commercial relationships/organisation of sales force and specific needs. No sub-segmentation of this market appears to be necessary as the assessment, in any event, remains unaltered. As a matter of fact, the competition problems detected for these small customers (elimination of EDP as the most likely potential competitor and, consequently, strengthening of GDP’s dominant position) emerge in the same way for all of them.
217. On the contrary, the Commission does not agree with the parties that the supply of gas to CCGTs, LDCs, and LICs constitutes one and the same market. The Commission, based on its investigation, considers that each of these three customer groups constitutes a distinct product market. The reasons and findings are described below.

Parties' and competitors' perceptions

218. Parties themselves view these three customer groups as clearly distinguishable groups of customers, which is borne out by form CO itself. Internal papers of both [...] ¹⁶⁵ and [...] ¹⁶⁶ show that [...] ¹⁶⁷

219. This perception is also shared by competitors active in Spanish and other gas markets:

Shell - Spain:

“In our commercial activities in Spain we typically group customers in:

‘Gas to Power’,

‘Very Large, Large and Medium Industrial Customers’,

‘Small I&C Customers’

‘Wholesale’ (i.e. sales to other commercialisers).

This broad segmentation is based on the fact that the business processes and also marketing approaches involved in each case are clearly different.” ¹⁶⁸

GdF- Spain:

“The segmentation of the customers corresponds to the one established by the Spanish regulation in matters of Third Party Access to the network.

- *Very large Industries (TPA 1.1-1.3),*
- *Large Industries (TPA 2.5-2.6),*
- *Small and medium (TPA 2.1-2.4),*
- *CCGTs (TPA 1.3). ”*

GDF further distinguishes between “Very large Industries” and CCGTs by the difference in customer relationship:

- CCGTs: Project team. “Each CCGT receives a specific offer which corresponds to the specifics of the demand” ;
- Very large industries: Key account “Gaz de France proposes its clients [very large industrial and other large customers] pricing formulae which take into account the duration of this type of contract and the characteristics of the industrial process, which permits to adjust prices and additional services like audit services or optimisation [of energy use] ” ¹⁶⁹

¹⁶⁵ [...]

¹⁶⁶ [...]

¹⁶⁷ [...]

¹⁶⁸ Shell’s reply to question 20 of the Commission’s Request for information dated 17 September 2004. (Bullet points added). This company has no sales to Residential customers in Spain which may explain the absence of this group in the segmentation.

¹⁶⁹ GDF’s reply to questions 20 and 21 of the Commission’s request for information dated 17 September 2004. (Bullet points added). This company has no sales to residential customers in Spain which may explain the absence of this group in the segmentation.

(“La segmentation de la clientèle correspond à celle établie par la réglementation espagnole en matière d’accès des tiers au réseau ”

Gas Natural:

For Gas Natural both CCGTs and LICs belong to the group of “industrial customers” receiving individualised treatment. However, they also see important differences:

CCGTs “*Very detailed contracts that differ also a lot from client to client to meet their specific requests; more than 35 bar; dedicated commercial attention; consumption very sensible to the pool and therefore stationarised [i.e. dependent on seasonal variations]; specific flexibility requirements for commissioning period*”;

LICs : “Standard contracts that can have slight differences if it is a liberalised client; usually more than 16 bar; dedicated commercial attention; consumption mainly not stationarised [i.e. not dependent on seasonal variations] (except eventually August vacations)”¹⁷⁰

EDF :

“The most important criteria for grouping customers on a gas market are consumption, profile and the uses of gas. Other criteria, such as purchase behaviour, margins... depend too much on local policies and local competition to be stated at a European level.”¹⁷¹

As indicated above, consumption per customer is very different between CCGTs on the one hand and LDCs and LICs on the other hand; very few industrial customers in Portugal reach the size of purchases of even mid-sized LDCs. On the demand profile see below. The use of gas, as outlined above, is clearly different with all three groups.

Iberdrola :

Iberdrola considers that the consumption patterns of CCGTs and large industrial customers are very different: large industrial customers are very stable gas consumers, with a reduced load factor during the week-end and for some of them at night. On the contrary, CCGTs are exposed to competing power generators, to hydro capacity, to maintenance so that the scheduling, and thus the gas consumption, of a CCGT is very erratic.¹⁷²

220. In their Response, the parties remark that the competitors’ views can only be taken as indications that competitors view these groups as separate *segments* not as separate relevant *markets*. The Commission only partly agrees. The competitors’ views are to be taken as indications that competitors distinguish between these groups for their commercial purposes. This means that they are to be considered *at least* as separate segments. In conjunction with the other distinctive elements referred to for the purpose

“Chaque CCGT fait l’objet d’offre spécifique correspondant aux particularités de la demande” ; “Gaz de France propose à ces clients [very large industrial and other large customers] des formules de prix prenant en compte la durée de ce type de contrat et les caractéristiques du process industriel, en lui permettant des mécanismes d’ingénierie de prix et des services additionnels tels que des prestations d’audit ou d’optimisation. ”)

¹⁷⁰ Gas Natural’s reply to questions 20 and 21 of the Commission’s Request for information dated 17 September 2004. See also Meeting Minutes: “GN distinguishes the following customer groups: CCGTs, cogenerators, industrial customers, domestic/commercial customers.”

¹⁷¹ EDF’s reply to question 20 of the Commission’s Request for information dated 17 September 2004. The parties’ Response takes EDF’s use of the expression “on a gas market” as indicating one single gas market. The Commission points to paragraph 3 of the Commission Notice on the definition of relevant market for the purposes of Community competition law (97/C 372/03) (“the Relevant Market Notice”), stating that “companies often use the term ‘market’ to refer to the area where it sells its products or to refer broadly to the industry or sector where it belongs”.

¹⁷² Meeting Minutes with Iberdrola

of market definition in this decision this same information corroborates the existence of separate relevant markets.

221. ENI's Response finally argues that competitors also suggest other criteria such as pressure level and volume of consumption which, in ENI's view, would lead to different conclusions in terms of market definition. The Commission reminds that a distinction by volume of consumption, not contradicted by ENI, has been retained for the purpose of market definition where the volume distinction is relevant for Portuguese legislation, i.e. between LICs and small customers. Concerning a possible distinction of relevant markets based on pressure level, it should be stressed that ENI itself has pointed out that it is irrelevant which large customers are supplied via the high pressure network and which ones are supplied via medium pressure networks. Moreover, the Commission observes that the distinction between high and lower pressure levels when it is used for purposes of market definition is generally a *proxy* for large demand (which is normally supplied from the high pressure network). In the Portuguese gas sector, however, this proxy is not applicable because, as a result of recent introduction of gas and less developed high pressure network, large users tend more to be established in areas where there is no high pressure supply available and connection to lower pressure pipelines is more economical. There is therefore, as also ENI has argued, no relevant distinction between large industrial customers supplied via the high pressure and the medium pressure network.

Different supply needs and consumption patterns

222. Power producers are a customer group with unique demand needs in terms of quantity and flexibility of supply:
- In Portugal each CCGT consumes an amount of gas which is much larger¹⁷³ than the amounts needed by individual industrial clients and by individual LDCs (see paragraph above).
 - The use of CCGTs can vary strongly in the course of the year (mainly depending on meteorological and hydrological conditions influencing hydro-power production which is often complementary to power production in CCGTs). Demand needs of CCGTs therefore cannot be foreseen with sufficient certainty.
 - CCGTs therefore need to combine long-term contracts [...]¹⁷⁴, which are necessary for establishing the basic economic and technical viability and supply security of the CCGT project, with short-term contracts for more limited periods.
 - Even in the long-term agreements the most important non-pricing provisions concern flexibility of supply. Clauses providing for considerable downward and upward flexibility from an Annual Contracted Quantity ("ACQ") are introduced.¹⁷⁵

¹⁷³ Five to six times as large as the largest LDC. Almost 10 times as large as the largest industrial customer.

¹⁷⁴ [...].

¹⁷⁵ Downward flexibility is determined by "Take or Pay" thresholds mitigated by "make up" provisions (if consumption falls below ToP level the deficit quantity needs to be paid but can be taken in the following

223. To illustrate the size of such yearly variation of CCGT consumption a comparison between the years 1999 (a dry year) and 2003 can be made.

Consumption of Turbogás and of EDP's dual fuel plant in 1999 and 2003

in Mm ³	1999	2003	1999 (as of 2003)
Long term quantities	[700-900]*	[700-900]*	[90-100]*%
Additional quantities	[500-700]*	[100-200]*	[300-350]*%
Total consumption	[1000-1500]*	[1000-1500]*	[130-140]*%

224. Monthly, weekly and daily variations even go beyond the above variations. This means that a supplier of such CCGTs, whether of short-term requirements (of existing or new CCGTs) or of long-term requirements (of new CCGTs) or of both, needs to have (a) a very important source of supply itself, and (b) considerable flexibility within its own supply (procurement). The short term requirements of the year 1999 equalled [90-100]*% of total Portuguese non-power-producer demand in that year and, after strong growth in the Portuguese gas sector, still would constitute more than total LDC consumption in 2003 and more than half of total large industrial consumption in 2003.
225. As to hourly supply it is relevant to note that, in ENI's words "the only customer groups whose consumption can be accurately analyzed in terms of hourly modulation, are power producers. This is so because each of the two CCGTs' natural gas consumption is measured, on an hourly basis, by a dedicated Gas Reduction and Metering Station."¹⁷⁶
226. The different supply needs of the three groups can also be shown by looking at peak-day-of-the-week variations of demand excluding the summer holiday period (August,) and Christmas (both of which periods show a special demand structure, which is also different for the three groups). The peak-day-of-the-week demand for the three groups differed as follows in 2003: [...]¹⁷⁷
227. The substantially different nature of CCGT demand to both LICs and LDCs is obvious. The fact that even the supply needs of LDCs differ considerably from the average supply needs of industrial customers is explicable by the fact that industrial customers tend to consume the same amount of energy all around the year whereas LDC customers (very likely due to the fact that more than [30-40]*% of LDC consumption is made by households and some [50-60]*% by households and services) have a stronger seasonal variation of their demand and need substantially more gas in colder winter months. These differences of supply needs and consumption patterns are

years) and "carry forward" provisions (if more than ACQ is consumed this reduces the ToP level in the following year or years). There are also upward thresholds of maximum annual quantity.

¹⁷⁶ ENI's reply to question 6 of the Commission's questionnaire of 27 September, 2004. Contrary to ENI's remark in its Response that metering of hourly consumption of CCGTs should not be considered since it "intervenes only *ex post*", the Commission considers that the fact that CCGTs are the only customers to have such metering is an additional distinctive element.

¹⁷⁷ [...]

mirrored in the contracts concluded between importers/suppliers and large wholesale and retail customers (see paragraphs 231 - 235)¹⁷⁸.

228. Finally the different necessity for the supplier to closely, or less closely, monitor and plan in advance the consumption of the different customer groups is reflected in different nomination requirements. CCGTs need to give annual, monthly and weekly forecasts and need to provide daily (and intra-daily) nominations. With regard to LICs only clients with a consumption of above 50 Mm³/y need to inform Transgás about their expected consumption on weekly basis or every two weeks.¹⁷⁹ For LDCs there are currently only annual forecasts with monthly resolution.¹⁸⁰
229. In their replies to the Statement of Objections, the parties, on the one hand, point out that some market participants have seen further distinctions between customer groups in terms of supply needs and consumption patterns. The Commission considers the existence of further submarkets a possibility but maintains that it is not necessary, for the purpose of the current decision, to subdivide markets any further as such further submarkets would not make any difference to its assessment.
230. Secondly, the parties argue that different consumption patterns of customer groups have not induced the Commission to find on different markets for these groups in the past. However, the Commission considers that the different supply needs in conjunction with consumption patterns imply that the nature of the product that is sold, including the essential service of delivering this product (or of guaranteeing delivery) to the customer, is different. The Commission also notes that, in its past practice, it has established the existence of different markets by distribution channel, for example, in consumer goods¹⁸¹, which were also based on supply needs (including delivery service) and consumption patterns. Also, the parties do not comment on the fact, mentioned in the SO, that the Commission has found on the existence of different products markets based on supply needs and consumption patterns in electricity.¹⁸²

Different type, duration and flexibility provisions of contracts

231. CCGT contracts are long-term contracts of some 15-25 years' duration. They are tailor made to the needs of each CCGT, in terms of gas quantities, modulation, flexibility,

¹⁷⁸ The parties' Response argues that the consumption cycle of LDCs cannot be considered as separate from LICs as half of LICs are served from the LDCs. The Commission notes that the LDCs do not purchase and resell the gas supplied by Transgás to LICs via the LDCs' distribution networks. Therefore this consumption cannot be considered to form part of the LDCs' consumption cycle. The Commission therefore maintains that the LDCs consumption cycle is substantially different from LICs' consumption cycles.

¹⁷⁹ [...]

¹⁸⁰ ENI's reply to question 3 of the Commission's questionnaire of 27 September, 2004, annex. The parties' Response argues that the circumstance that LDCs have less bounds for nomination requirements is simply a matter of usual policy in any Member State, where the safeguard of supplies to households implies that surveillance must be concentrated on other groups. The Commission takes note of this argument as one that rather corroborates than contradicts its finding on the distinctness of the supply characteristics to LDCs.

¹⁸¹ Cf. case COMP M. 1990 - Unilever/Bestfoods, Commission decision of 28.9.2000 regarding the supply of food products to supermarkets and to the food service sector (OJ C 311, 31.10.2000, p. 6). Cf. COMP. M. 2640 - Nestlé/Schöller, Commission decision of 25.02.2002, regarding supply of ice cream for households (via supermarkets and other retail outlets), for impulse consumption (via impulse outlets) and for large customers (via food service outlets channels): OJ C 155, 29.6.2002, p. 15.

¹⁸² Cf Case 2187 – Verbund/Energie Allianz.

and price level, and indexation.¹⁸³ They have elaborate clauses on flexibility and may provide for renegotiation or adaptation possibilities. Short term contracts complement these long-term contracts and add extra overall flexibility. From the evidence presented to the Commission by the parties on TER[...] it can be concluded that these short term contracts are [...]*

232. LICs typically conclude contracts with a much shorter duration than the basic CCGT contracts. Information provided on contracted market by Transgás with industrial consumers shows that [50-60]*% of Transgás current contracts with industrial customers will terminate by [...]* and that a further [30-40]*% will terminate by [...]*. The current duration of the first contract for the supply of natural gas entered into by an industrial customer is generally [...]* years. [...] ¹⁸⁴ The duration of these contracts will tend to decrease significantly after the opening of gas markets to competition.¹⁸⁵¹⁸⁶¹⁸⁷
233. As concerns LDCs, a different kind of annual flexibility of supply is needed. Existing contracts with LDCs [...] provide very limited annual downward flexibility¹⁸⁸ but [...]*. While there seem to be no rules on minimum daily consumption in the LDCs' supply contracts there are rules on maximum daily consumption (limited to about [90-100]*% above the annual average daily consumption). Current LDC contracts are essentially the same for all six LDCs differing merely in the quantities and delivery points specified.
234. In their reply to the Statement of Objections, the parties argue that the contents of such contracts will necessarily change when competition will be introduced in such markets and competitive pressure will oblige suppliers to better shape their contracts to satisfy their customers' requests. However, The Commission has explicitly considered the likely effect of the opening of the Portuguese markets to competition on LIC contracts in the Statement of Objections. ENI does not argue that the effect of the opening of the supply to CCGTs will lead to substantially reduced long-terms contracts such as to make CCGTs' contracts more comparable with LICs' contracts than is currently the case. Therefore, as the duration of LIC contracts is likely to decrease, if the duration of CCGT contracts remains unchanged then the gap between both types of contracts will widen rather than become narrower. Also the fact that CCGT short-term contracts will show a much more irregular rhythm and more irregular durations than LIC contracts is not challenged by ENI, thereby further confirming the distinction between both customer groups. As to LDC contracts, ENI's argument that the Commission ignores the prospective development of demand from LDCs is not justified either.
235. Therefore, on the basis of all the elements that were presented by the parties and by other market participants, the Commission has reached the conclusion that LDC contracts will not be interchangeable with either CCGT contracts or LIC contracts.

Margins are different

236. Margins and margin developments are different for the three groups:

¹⁸³ ENI's reply to question 4 of the Commission's questionnaire of 27 September, 2004

¹⁸⁴ Reply to question 23 of the Commission's questionnaire of 4 June 2004.

¹⁸⁵ In Spain, 1- 2 year contracts are the norm. (see CEPSA reply phase II).

¹⁸⁶ [...]

¹⁸⁷ [...]

¹⁸⁸ [...]

- In considering [...] ¹⁸⁹
- GALP budget figures state different margins and margin progressions for the three groups: [...] ^{*}

NG Supply and Transport Budget 2003 ¹⁹⁰

237. The parties' Response notes that margins vary not only among different customer groups, but also among different clients within the same group. However, the fact that ENI and GALP see these margins per customer group as the appropriate way to aggregate customers is proven by the fact that it is in exactly this way that ENI and GALP themselves have aggregated margins in the company's budgets and entry strategy papers. If the variation of margins was entirely random, such information would be devoid of all meaning.

Customer relationships are different

238. Customer relationships between suppliers of natural gas and CCGT customers usually begin 2-3 years before the start-up of the power plant. Relations at that stage seem to be characterised by the existence of a project team. During this period before the plant's start-up supplier and customer negotiate the supply contract and Transgás develops the necessary supply infrastructures, while also providing technical support to the client in all matters concerning the supply of natural gas. Therefore when the supply of natural gas actually starts, a close relationship between Transgás staff and the power producer has already been established. After the start-up of the natural gas supply contract, Transgás provides fully personalized support to power producers by having one key manager solely dedicated to this specific customer group. ¹⁹¹
239. A team of industrial key account managers is responsible for the customer relationships and the contractual management of large industrial clients. In particular each key account manager is responsible, on average, for nearly [...] ^{*} contracts. ¹⁹²
240. With regard to LDCs one key-account manager is responsible for client support with respect to any issue related to the management of contracts with the LDCs. ¹⁹³
241. The fact that (a) the internal organisation is such that different key account managers take care of different customer groups and that (b) the intensity of customer contact between the three groups is substantially different is a further indication of important differences in their supply needs.
242. The parties' Response notes, by way of comparison, that impulse demand for soft drinks has never induced the Commission to find a separate "impulse" market for soft drinks. However, and irrespective of whether such comparison is meaningful in the present case, ENI ignores that the Commission has very well defined a separate "impulse" market for ice cream as well as separate markets for consumer food products between retail/supermarket outlets and catering/food service outlets. ¹⁹⁴ Also the

¹⁸⁹ [...].

¹⁹⁰ [...]

¹⁹¹ ENI's reply to question 4 of the Commission's questionnaire of 27 September 2004.

¹⁹² Ibid.

¹⁹³ Ibid.

¹⁹⁴ See, inter alia, COMP. M. 2640 - Nestlé/Schöller (in this case distinguishing explicitly between large customers and households) and COMP. M. 1990 - Unilever/Bestfoods.

parties' other argument suggesting that a company's commercial relationships with its clients are an exclusively internal matter with no impact on the issue of market definition cannot be agreed with. The Commission considers that, rather than asking whether to distinguish between clients who use a certain free service offered by a department store and those who do not, the issue is whether or not a certain product requires a certain service to go with it.¹⁹⁵

The commercial needs of resellers are different

243. Generally resellers can be expected to have different service needs than large final customers. Resellers may need support in terms of risk management, CRM software, marketing, metering or billing. Large final customers will rather need technical support in view of optimisation of energy use.
244. The parties' Response remarks that the Commission's views in the SO are unsubstantiated and calls into question the different service needs for LDCs. It does not however, question the different needs for LICs as mentioned in the last sentence of the previous paragraph. The Commission therefore maintains that the service needs of LICs will be substantially different from those of LDCs.

Growth dynamics are different

245. As shown in the table in paragraph 180, while the consumption of the industrial sector and the consumption of LDCs has seen rather steady growth in Portugal, the consumption of CCGTs has been characterised by quite large annual variations without any consistent growth between the full entry into force of Turbogás in 1999 and 2003. Moreover, the growth prospects for CCGTs and for the other two customer groups are substantially different. The addition of two units in 2004 and one unit in 2006 will mean that between 2003 and 2007 gas consumption by CCGTs will grow much quicker than consumption by LDCs and LICs. [...] ¹⁹⁶

Biannual growth	2001-2003	2003-2005	2005-2007
CCGTs	[0-10]*%	[30-40]*%	[50-60]*%
LDCs	[20-30]*%	[10-20]*%	[10-20]*%
LICs	[20-30]*%	[20-30]*%	[10-20]*%

246. This discrepancy may become even more acute from 2008 onward when [...] ¹⁹⁷ The fact that the market for gas supplies to power producers may grow much quicker than other segments corresponds to the views expressed by the parties along the procedure.

¹⁹⁵ As regards the parties' comparison, one might say that being served an ice cream at a restaurant is not the same as buying (maybe the same) ice-cream in a supermarket. This is true irrespective of whether both happen to be part of the same shopping mall or department store.

¹⁹⁶ These figures are derived from the following information provided by the parties: LIC consumption 2004-2007: Reply to question 23 of the Commission's questionnaire of 4 June 2004. LDC consumption 2004-2007: Eni's reply to question 31 of the Commission's questionnaire of 30 August 2004. CCGT consumption 2004-2007 (= Total consumption minus LDC and LIC consumption). Total consumption provided in Reply to question 51 of the Commission's questionnaire of 4 June 2004, table 10. Consumption of three groups: GDP, form CO.)

¹⁹⁷ ENI's reply to question 11 of the Commission's questionnaire of 26 July 2004: (For period 2008-2012:) [...]

247. The parties' Response remarks that growth prospects may also be different between different segments of a market as well as between different individual companies. The Commission does not deny this but maintains that different growth prospects in supply of natural gas to LDCs, LICs and CCGTs are a relevant element when considering likely future conditions of competition for supply of natural gas to LDCs, LICs and CCGTs in Portugal. For instance, [...] will considerably reduce incentives to shift supply to one of these groups of customers in Portugal.
248. The parties' Response furthermore states that different reference periods for CCGTs (1999-2003, or 2000-2002, or 1998-2001) would bring different results as to the past growth of demand for CCGTs. However, the very same fact underlines the unevenness of CCGT demand growth, as has been referred to by the Commission in the Statement of Objections, and is an important difference between CCGTs' demand and demand by other customer groups.

Arbitrage and supply side substitutability are insufficient

249. The (hypothetical) switching of supply from the supply of LICs and/or of LDCs to the supply of CCGTs would not be sufficient to defeat price increases of a hypothetical monopolist in the supply of natural gas to CCGTs in Portugal because the differences in size and in flexibility requirements make it unlikely that suppliers to LICs, and (possible) suppliers to LDCs, could easily switch their supply to CCGTs in the short term. Absent a substantial modification of the import contracts such switching to CCGTs would require the termination/non-conclusion of a large to very large number LIC contracts and would therefore imply a complete reorientation of the entire business model (including risk management) of these suppliers.
250. Regarding differences in volume it needs to be remarked that the consumption of CCGTs surpasses the consumption of LDCs and of even the very biggest industrial customers by far. Consumption of LDCs surpasses the consumption of all but the very biggest LICs. Irrespective of other differences of supply conditions, companies supplying LICs would therefore find it difficult to shift their supply to the other two groups of large customers in a timely manner. The same argument applies to switches in supply from LDCs to LICs.
- The average consumption of Turbogás 1999-2003 was [...] Mm³/ year. The annual contractual quantity of the two TER units in operation by the end of 2004 is [...] Mm³.
 - Total Portuguese LDC consumption in 2003 was [...] Mm³, much less than the demand of a single two-unit CCGT. Portugás consumption in 2003 was [...] Mm³ and the average consumption of LDCs in 2003 was [...] Mm³.
 - By contrast the average consumption of LICs was merely [...] Mm³. There were only two LIC customers in Portugal in 2003 (both controlled by EDP) with an annual consumption of above [...] Mm³. The demand of at least [...] other industrial customers would have to be taken together to satisfy even the annual average consumption of LDCs. In order to satisfy the annual demand of Portugás the demand of the [...] biggest other customers (not controlled by EDP) would be necessary. In order to even satisfy the short-term requirements (additional quantities) of Turbogás in 2003 ([...] Mm³, which was a value at the lower end

of its annual short-term demand,) the demand of the [...] * biggest non EDP-controlled LIC customers in 2003 would be needed.¹⁹⁸

251. In respect to differences in supply volumes, the parties' Response argues that further to opening of gas markets, "*industry buying groups / consortia / companies*" would appear thus increasing individual LIC's purchase volumes. The Commission notes that ENI does not substantiate this claim which it bases only on a vague reference to "foreign experience". This omission is significant considering that ENI has first hand experience of and access to information in at least three other EU natural gas markets in which the demand of LICs is already liberalised, namely, Italy, Spain and Germany. It is therefore far from clear, and indeed remains very doubtful, that the demand of industrial buying groups/consortia would have the effect of levelling the very important size differences in the demand of LICs, LDCs and CCGTs.
252. Volume and flexibility planning difficulties are not the only obstacles for switching supply. Switching supply also involves a change in marketing strategy, staff policy (qualification, training), risk management, flexibility management, contract management, and pricing and margin calculation. It may also require a different portfolio of additional services to be offered to the clients. For example, second-tier wholesale customers might require specific logistic and commercial support (like multi-customer metering services, multi-customer billing services, multi-customer marketing support) which not all companies supplying retail customers would be willing or able to provide. By contrast LICs will be very interested in technical support to optimise their energy consumption.
253. As regards arbitrage it needs to be underlined that such arbitrage is of course possible between all three customer groups within the same group of companies. For example, Iberdrola underline that the operation of CCGTs and being active in gas retailing permits optimisation of the management of gas and electricity as there are opportunities of arbitrage between selling gas or burning it for power, depending on the respective prices. Such "internal" arbitrage will be more useful between LDCs and CCGTs as these have partly complementary supply needs. Households and commercial customers need more gas in winter whereas in winter in Portugal also the hydro-power production is higher and therefore demand for CCGT power is lower. Internal arbitrage will be less successful between LICs and the other two groups as LICs have a fairly flat demand in summer and winter. But for importers/suppliers supplying to LDCs (or to other suppliers supplying current LDC customers) or to LICs, to operate CCGTs in the same group of companies will always mean a "safety net" advantage in case important (or numerous small) contracts with LICs or LDC customers are either lost or not acquired as foreseen.
254. However, this possibility of arbitrage at supplier/importer level (within the same group) does not imply that such arbitrage (sales between customers) is possible between the customers themselves. [...] *¹⁹⁹ Second, they do not necessarily have the interest of doing so: even big industrial customers cannot be expected to be interested in energy trading which is not their core business and not their area of expertise. These customers will rather use their bargaining power to achieve cheaper prices than try to achieve an extra margin through selling natural gas. [...] *

¹⁹⁸ Values, other than as already cited above, are taken from: annex to Eni's reply to the Commission's questionnaire of 19 August 2004; annex to question 3 of Eni's reply to the Commission's questionnaire of 27 September 2004.

¹⁹⁹ [...]

255. In any event, the difference in supply volumes makes *effective* arbitrage from LICs to LDCs and CCGTs and from LDCs to CCGTs impossible, particularly in the absence of a fully developed spot market, which cannot be expected to materialise in Portugal in any foreseeable future. Arbitrage can therefore only be possible from CCGTs to LDCs and to LICs and from LDCs to LICs. Essentially such arbitrage would mean nothing less than that CCGTs would become wholesalers to LDCs and that both CCGTs and LDCs would become suppliers to LICs. Such entry into new markets is not excluded. (As will be discussed below such entry is even highly likely as regards EDP which has access to both a CCGT [TER]* and an LDC ([Portgás]*.) However entry would happen for commercial reasons and in search of additional profit margins and cannot be expected to “defeat” price discrimination between these three customer groups.
256. The parties’ Response claims that the Commission ignores the circumstance that the CCGTs’ demand for gas will be liberalized before the one of LDCs and LICs. In ENI’s view, the supply to CCGTs should therefore be analysed first and then in a separate step, the possible shifting of supply from CCGTs to LDCs and LICs and vice versa.
257. The Commission notes, first, that the opening to competition of supply to CCGTs, originally foreseen for 2004, has been postponed to 2005 whereas the opening to competition of supply to LICs is foreseen to be advanced to 2006. Therefore the temporal gap between supply to LICs and to CCGTs is very much reduced limiting its competitive significance. This is all the more so as no new CCGT will start operation in 2005 and 2006, except EDP’s third unit of the TER power plant for which the gas contract with GDP is already in place. This limits the potential beneficiaries from an opening of CCGTs’ gas supply to the short term requirements of EDP’s gas-fired power plants and Turbogás. Besides, it is in the very nature of these short-term requirements that their exact size cannot be foreseen as it is strongly dependent on the highly-fluctuating level of utilisation of the CCGT.
258. Secondly, contrary to the parties’ claim, the potential competitive effect of this temporal sequence of market openings to competition is well considered by the Commission which analysed the potential shifts of supply from CCGTs to LICs and LDCs.
259. Next, the parties also claim that sufficient spare volumes of natural gas are available. They point to larger players sitting “*over the Spanish border [...] in an oversupplied market*”. On this, the Commission firstly notes that the question of whether or not the Spanish natural gas markets will be oversupplied at the point of time of effective opening of the Portuguese natural gas markets remains open to discussion. The alleged oversupply of the Spanish markets at such a moment in any event has not been shown by the parties in their Response.²⁰⁰ Secondly, even the existence of such oversupply in Spain would mean little without the means to shift the supply to Portugal which depends *inter alia* on the availability of import capacity. Given the lack of effective opening of entry points the issue is therefore a merely hypothetical one.²⁰¹ Thirdly, the shifting of supply from Spain to Portugal relates rather to the geographic dimension of

²⁰⁰ There are indications that this perceived oversupply may a) be a temporary one levelling off in a few years and b) Spanish players such as Gas Natural have important flexibilities in their supply contracts regarding sale of natural gas in Spain or in the USA which may render this perceived “oversupply” a mere virtual one. It is noted that such perception has an effect on incentives to market entry.

²⁰¹ Evidently the effective opening of sufficient available capacity at the pipeline interconnections between Spain and Portugal are more important in this respect as diversion of LNG ships is less flexible and requires bigger quantities.

the market than to the scope of the product markets. In this respect, the parties have never claimed the existence, or timely emergence, of a pan-Iberian natural gas market.

260. The parties' Response furthermore claims that the Commission does not demonstrate that switching supply from one customer group to the other would imply significant additional costs.
261. The Commission considers that such argument does not bear closer scrutiny. As the parties have itself repeatedly argued,²⁰² the provision of flexibility in gas supply is achieved at a price and represents a certain value reflecting underlying costs. ENI has in particular argued this in relation to the flexibility on the basis of GDP's Sonatrach contract available to GDP on the Spanish/Portuguese pipeline entering Portuguese territory at Campo Maior. Therefore the flexibility of supply to CCGTs in Portugal evidently has a certain extra cost to be borne by players wishing to supply CCGTs in Portugal even if they are established in Spain (and even assuming that there were sufficient available interconnection capacity). To a lesser extent this is also true for supply to LDCs which, as shown above, have a significant seasonal variation of demand. Therefore any shifting of supply from LICs to LDCs, or from LICs to CCGTs, or from LDCs to CCGTs implies substantial extra costs. As to switches of supply in the opposite direction requiring lesser flexibility, these would not constrain the competitive behaviour of suppliers to CCGTs²⁰³ and to LDCs as these are the customer groups requiring most flexibility. In addition, the flexibilities necessary for CCGTs and LDCs are substantially different in their characteristics so that even timely switches from "high-flexibility" CCGTs to "medium high-flexibility" LDCs are not easy to manage.
262. Nor are these flexibility costs the only costs to be incurred by companies switching their supply from one customer group to another. As outlined, companies have to put in place a dedicated sales force for each of these customer groups which, in particular as regards LICs, requires a certain critical mass of customers, and in respect to all customer groups requires a certain critical mass of sales volumes per group, in order to operate cost efficiently. The parties' Response remarks "the potential newcomers themselves state that this [i.e. the setting up of dedicated sales forces; staff/marketing capability] is not a problem". For this, however, ENI cites merely the views of a single market participant²⁰⁴ which in the Commission's view does not permit the conclusion that these costs, in combination with the commercial risks are insignificant. In discussing this market participant's views²⁰⁵, ENI also neglects that this market participants' Spanish natural gas key account managers will face not insignificant language barriers and other acceptance problems with Portuguese customers so that it is quite likely that this market participant as all other potential entrants, will need to either itself train specific Portuguese staff or hire such staff from the incumbent. In addition, even in the latter case, the customers and customer contacts do not simply

²⁰² See Minutes of the Meeting with the Commission on 20 October.

²⁰³ As regards CCGTs this seems to be implicitly acknowledged by ENI's Response which, in paragraph 32, states: "In any event, and even assuming that the Commission were right in concluding that LDCs and LICs are not a competitive constraint in what concerns supply to power generators, this would rather result in stating that natural gas demand by power generators should be treated as a separate market since 'a) it is possible to identify clearly which group an individual customer belongs to at the moment of selling the relevant products to him and b) trade among customers or arbitrage by third parties should not be feasible'.

²⁰⁴ Gas Natural, para 44 of ENI's Response.

²⁰⁵ In para 54 of ENI's Response.

follow with the key account managers once they leave a certain company so that new entrants in these markets will have to sustain their marketing investments for a longer period of time before being able, if their customer acquisition is successful and margins of their contracts are positive (which is not guaranteed), to cover these costs with revenues. In sum, this requires substantial investments and prevents timely shifts in supply from one customer group to the other.

263. These additional costs are not sufficiently offset by the fact that, according to the parties, operating in these neighbouring markets of supply of natural gas to CCGTs, LDCs and LICs in Portugal brings additional cost efficiencies, in particular regarding easier achievability of a critical size to support the negotiation of an upstream gas contract and to support the cost efficiency of the supply chain. For this it is important to consider that entry in each individual market entails specific commercial risks. Cost efficiencies can therefore be realised more easily by companies already firmly established in one or two of these product markets which only have to bear the incremental commercial risk of new entry into one additional market. In Portugal this is not the case for any company. These cost savings therefore have a larger impact on GDP's competitive position vis-a-vis new entrants than on the issue of product market definition.
264. It needs to be remembered that the Commission's Relevant Market Notice defines sufficient supply substitution as one that happens in the "short term" (defined as a period that does not entail a significant adjustment of existing tangible and intangible assets) (Notice, para 20) or "immediately" (Notice para 21). In addition to pointing to significant adjustment of existing tangible and intangible assets the Notice also draws attention to "additional investments, strategic decisions or time delays" which prevent taking supply side substitutability into account at the stage of market definition.
265. In view of these facts and having considered ENI's arguments, the Commission maintains that supply side substitutability and arbitrage are not sufficient, to lead to a widening of the relevant product markets in this case.

ENI's general remarks on market definition

266. ENI alleges that grounding the definition of the relevant market on features such as parties' and competitors' perceptions, difference in margins or different growth rates deviates from good practice and the principles of the Relevant Market Notice
267. The Commission does not share this view. It does not claim, nor has it claimed in the statement of Objections, that any of these elements in itself is sufficient to lead to the finding of separate markets. However, all these criteria are relevant and have to be taken into consideration for the purpose of market definition. The Commission recalls that the Relevant Market Notice does not erect a closed system of evidence that may be used to define relevant markets in individual cases. It also considers that the perception of parties and of competitors on how they group the market *in commercial terms* very well influences competition between firms on these markets or market segments, especially if parties' and competitors' perceptions converge to a significant degree. Prospective growth rates and achievable/achieved margins are an important element of commercial decisions to be active or not on a specific market. Regarding the latter, in a system of monopoly the Commission cannot have access to more information than the one available to the monopolist. Different margins in this context may well point to different cross price elasticities.
268. The parties furthermore cite the Notice's statement that "*a relevant product market comprises all those products and/or services which are regarded as interchangeable or*

substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use" alleging that the Statement of Objections does not review these elements cited in the Relevant Market Notice.

269. The Commission does not share ENI's view: the Commission has, in its SO, underlined the different product characteristics of the product/service packages "supply of natural gas to, respectively, CCGTs, LDCs and LICs". The Commission has shown that it is incorrect that in all these cases a simple commodity product "X m³ of natural gas" is sold and that, rather, the flexibility service and the technical and customer care service provided by the supplier are essential features of each particular product/service package which makes this product/service package different for all three customer groups. The Commission has preferred to elaborate on margins rather than on price differences, because in a monopolistic market, and to the extent they differ, margins are more informative as regards the degree of market power of the dominant firm with respect to different customer groups and consequently the likely price ranges after market opening. The Commission finally reiterates that, as it has argued in the SO, the use of natural gas is obviously a different one for CCGTs (burning natural gas for purposes of electricity production), LDCs (selling on gas to their small customers) and LICs (utilising gas as a power source for industrial purposes).

Conclusion

270. For the reasons explained above and for the purpose of the present decision, the following gas product markets will be considered:

- Gas supply to CCGTs
- Gas supply to LDCs
- Gas supply to LICs (Large Industrial Customers)
- Gas supply to small customers (namely smaller industrial, commercial and domestic customers).

3. Geographic markets in Natural Gas

271. The parties consider the supply of natural gas in Portugal to be national in scope, except that they tend to view the supply to customers of LDCs as local in scope.

272. The Commission agrees that the markets concerned by this operation as defined above are no wider than national.

273. The technical and regulatory framework for any wider market has not yet been foreseen. It is also worth noting that no competitor is currently in a position to have access to transport capacity in the pipeline which interconnects Spain and Portugal. Even if regulation was imposed to let third parties access the pipeline, documents by the parties indicate that there is hardly any available capacity which could be booked by competitors to import gas from Spain into Portugal on a permanent basis. Therefore the Commission considers that all markets defined in this communication will remain no wider than national in the foreseeable future.

274. Regarding the supply to small customers (namely small industrial customers, commercial customers and households), the question arises whether this market is

narrower than national. Indeed, LDCs are currently enjoying local monopolies in the area defined by their concessions.

275. However, subsequent to the opening to competition of the supply of natural gas to small customers, this area can be expected to become a national market in scope within a short period of time. This is for a number of reasons: First, the regulatory rules will be uniform in all Portugal. Second, the creation of unbundled non-regulated supply companies will be an incentive to compete on a national basis as these companies will on the one hand have to invest in branding on a national scale and on the other hand will have an incentive to compete on a national scale in order to reach critical mass faster and to take a share of customers switching to the open market from their competitors' regulated supplier.²⁰⁶ Third, potential new entrants will necessarily have to compete on a national scale in order to reach critical mass. Fourth, also GDP will have an incentive to rationalise its shareholdings once it has consolidated its majority positions.²⁰⁷ Such rationalisation will be even quicker for the new non-regulated supplier(s) for which a national-wide organisation, for the same reasons as for other non-regulated suppliers and new entrants, would be much more efficient.²⁰⁸ Fifth, it must be mentioned that, by analogy to the gas market for supply to small customers, the supply of electricity prior to the opening of the markets was also organised through several commercialisation areas. After the opening of the market (and therefore the national dimension thereof), EDP has merged its local companies within one national company given the national scope of the market.
276. Finally, the experience from Spain seems to indicate that such a transformation can happen in a very short time. The Commission's market investigation on Spain has given very strong indications that Spanish markets may have become national very quickly after opening to competition of these customer groups. Market participants clearly indicated that they, through their commercial suppliers ("comercializadoras"), have become active outside their incumbent areas and, on principle, although setting certain marketing priorities, try to cover the whole of the Spanish territory.
277. Given the above circumstances, such a development is *a fortiori* likely also in Portugal whose national territory is much smaller.²⁰⁹
278. In any event, for the reasons explained below, even if the market for the supply of gas to small customers were to remain regional for a longer period, the competition problems detected for small customers as regards elimination of potential competition (and, consequently, strengthening of dominance) would remain. Therefore the geographical market definition with regard to the market for the supply to small customers can, for the purpose of this decision, be left open
279. In their reply to the Statement of Objections, the parties do not challenge the above geographic market definition(s).

²⁰⁶ See also case COMP/M. 2947 - Verbund/Energie Allianz, Commission Decision 2004/271/EC of 11 June 2003, where, in the small customer electricity retail market, the Commission found that the activity of the new suppliers progressively transforms previously local markets into national markets (paras 96 and 126).

²⁰⁷ See the example of EDP Distribuição in electricity.

²⁰⁸ See the example of Austria where six local utilities in gas and electricity have combined their activities to "Energie Allianz".

²⁰⁹ Also the lack of any federal organisation in Portugal should be noted.

V. COMPETITIVE ASSESSMENT

A. Electricity markets

1. Wholesale of electricity

280. The Commission takes the view that the operation, for the reasons set out below, would reinforce EDP's dominant position in the wholesale electricity market in Portugal, as a result of which effective competition would be significantly impeded in this market.

(a) EDP holds a dominant position on the wholesale market for electricity in Portugal

281. Following the Commission's in-depth investigation, it appears that EDP holds a dominant position on the wholesale market in Portugal, irrespective of whether it is considered under the current structure or after the termination of the PPAs.

282. EDP's significant market power is reflected by several elements.

EDP holds [70-80]% of generation capacity, accounts for [70-80]*% of generation and is the largest importer of electricity*

283. Under the *current structure*, in which energy traded at wholesale level in the open segment of the market (SENV) accounts for nearly 15% of the total electricity consumption, EDP accounts for [70-80]*% of the energy sold in the liberalised wholesale market, that is, generated by EDP within SENV or imported from Spain²¹⁰.

284. EDP holds 100% of current generation within SENV²¹¹ and import lines from Spain are frequently congested.²¹² Significant new capacity has been and will be added in 2004 and will further strengthen EDP's dominance. This new capacity is the first two blocks of EDP's CCGT in Ribatejo ("TER") of which one block of 400 MW is already in operation and one block of [...]*

285. Although imports from Spain represent a significant share of the total energy traded in SENV, imports by EDP or its subsidiaries accounted for [50-60]*% of the total imports, whereas competitors represented only [30-40]*% and REN [20-30]*%²¹³. EDP's shares in imports may fluctuate in the future, according to EDP's strategy. In particular, despite the expansion of its generation capacity in Portugal, EDP could choose to keep importing a small part of its needs from Spain (for example from Hidrocantábico) and hence significantly reduce the level of interconnection available for its competitors. Lastly, it must be kept in mind that the electricity imported by competitors accounts only for 2% to 3% of the overall power consumption in Portugal.

286. As regards EDP's share of the total installed electricity generating capacity and of the net generation of electricity in Portugal, the situation in 2003 was as follows:

²¹⁰ Form CO, Appendix 10, page 24.

²¹¹ Except as to the possibility of cogenerators, to the extent to which they are not controlled by EDP, to sell their surplus electricity production in SENV. Strictly speaking, however, this electricity is not produced in SENV but in PRE.

²¹² See paragraph above.

²¹³ Reply to Question 82 of the Commission's Article 11 letter of 29.6.2004. A major part of the total imports of electricity in Portugal in 2003 ([...]GWh) was for SENV consumption ([...]GWh).

2003	Capacity		Net Generation	
SEP	8 625 MW		36 152 GWh	
EDP	7 051 MW	81.7 %	26 582 GWh	73.5 %
Turbogás	990 MW	11.5 %	5 403 GWh	15 %
Tejo Energia	584 MW	6.8 %	4 167 GWh	11.5 %
SENV	647 MW		908 GWh	
EDP	647 MW	100 %	908 GWh	100 %
PRE	2 129 MW		3 697 GWh	
EDP	241 MW	11.5 %	1 041 GWh	28 %
Others	1 888 MW	88.5 %	2 656 GWh	71 %
Total	11 401 MW		40 757 GWh	
EDP	7939 MW	69.6 %	28 531 GWh	70 %

Source: Parties (Form CO, Appendix 11)

287. As shown by the table above, EDP controls 70 % of the total installed generating capacity and 70 % of the net generation in Portugal, far ahead of other operators. Turbogás, a company controlled by the German power company RWE²¹⁴, in which EDP holds a 20% stake, accounts, through its CCGT plant, for 8.6 % of the total installed capacity and for 13% of the net generation. Tejo Energia, a joint venture between the British company International Power and the Spanish group Endesa (and in which EDP holds a 10% stake), represents 5 % of the installed capacity and 10 % of the Portuguese generation (coal-fired plant). Other special regime producers (PRE) represented 16% and 6% of the installed capacity and of electricity generation, respectively.

288. [...] ²¹⁵

289. It is therefore clear that, thanks to its generation capacity, EDP is dominant on a Portuguese wholesale market irrespective of whether such wholesale market currently encompasses both SEP and SENV together, or just SENV and, if a market, SEP, individually.

EDP will remain dominant after the abolition of the PPAs

290. When considering the wholesale market after the early termination of the PPAs, which is expected soon, EDP's dominance will be perpetuated for the reasons described below.

291. On the supply side, all previously bound generation will then be available on the opened wholesale market and will therefore comprise the entire Portuguese power generation as well as imports from Spain.

²¹⁴ RWE's shares have recently been purchased by International Power. This transaction has been cleared by the Portuguese competition authority. EDP has informed the Commission on 26.10.2004 that it has concluded, in exchange for the waiving of this pre-emption right, an agreement with International Power that will confer EDP certain additional options whose exercise is subject to the approval of the relevant competition authorities.

²¹⁵ [...]

EDP's Portuguese generation portfolio will remain unmatched

292. EDP's pivotal role on the market will remain unaltered, not only because of the size of its generation capacity, but also because of the diverse power generation portfolio, including oil, coal, natural gas and hydro plants, as well as other renewable energies. Such a "generation mix" allows EDP to enjoy considerable marginal price-setting capabilities. Indeed, as a result of the opportunity cost and marginal cost characteristics of the different production technologies, coal plants tend to set prices mainly to address the base load demand whereas hydroelectric plants, gas-fired plants and occasionally oil-fired plants, tend to dominate during peak periods. In that respect, the Commission's investigation indicates that, between 2001 and 2003, EDP operated the power plant that set the marginal price of electricity supplied to REN (that is, the power plant with the highest variable cost that is used to meet demand) in [60-80]*% of the time²¹⁶.
293. Given the breadth and the size of EDP's generation portfolio, this situation will not change to any appreciable extent, neither as a result of the termination of the PPAs, nor as a result of imports, nor as a result of potential capacity additions of competitors.

The CMEC compensation scheme favours incumbents

294. In this context, account must also be taken of the fact that a compensation scheme will soon be implemented by the Portuguese government in order to compensate power generators, previously covered by PPAs, for the possible loss that they will incur following the abolition of these agreements. Apart from TER which started in 2004, the vast majority of EDP's generation capacities are covered by the stranded cost scheme.
295. As explained by the Commission in its decision of 22 September 2004 (State aid N 161/04- Portugal Stranded costs in Portugal), "*after the termination of the PPAs, the producers will receive compensation that will enable them, despite the opening of the market, to maintain the volume of their sales (and thus limit the risks they would face otherwise) even if the related plants are intrinsically less efficient than the plants that potential entrants may be willing to build in the future*". As a result, EDP will be able to maintain the operation of the whole of its generation portfolio, including the operation of plants which otherwise, in the absence of such a scheme, would be less competitive than new gas-fired power plants.
296. For the reasons already stated above in the context of the geographic market definition, the implementation of this compensation scheme may have a significant impact on the formation of prices on the market and on the incentives of the market players. In particular, it has been pointed out in the Commission's market investigation that such a scheme help protect the incumbent against potential entrants since the incumbent may use it to lower prices (and thus new-entrants' revenues and margins) without losing money. In its strategic documents, EDP itself underlines the positive effects of this 10-year scheme for the operation of its generation capacity²¹⁷. Thanks to the implementation of a compensation scheme, the termination of the PPAs will not, therefore, negatively affect EDP's dominant position
297. In their replies to the statement of objections, the parties submit that, since it has raised no objections on the compatibility of the aid with the common market, the Commission

²¹⁶ [...].

²¹⁷ [...]

must have considered any potential distortion of the CMEC scheme to be limited; otherwise, it could not have approved such a scheme.

298. However, the mere fact that, by decision of 22 September 2004, the Commission has considered this State aid scheme to be compatible with the common market in light of the specific objectives set out by Article 87(3)(c) of the EC Treaty²¹⁸ does not prevent it from considering the consequences of such a scheme on EDP's position for the purpose of this Decision. On the contrary, it follows from the case-law that "*in adopting a decision on the compatibility of a concentration between undertakings with the common market the Commission cannot ignore the consequences which the grant of State aid to those undertakings has on the maintenance of effective competition in the relevant market*"²¹⁹. In addition, as explained above, the Commission explicitly considered in its decision of 22 September 2004 that the award of compensation to power generators for the abolition of the PPAs entailed an advantage to their beneficiaries, the by far most important of which is EDP. Therefore, the Commission is not inconsistent with its previous decision when considering, for the purpose of the present decision, that the compensation granted by the Portuguese authorities following the abolition of the PPAs will favour the incumbents and, at the very least, will not negatively affect EDP's dominant position.

EDP Distribuição's role as regulated retailer strengthens EDP

299. One should also take account of the fact that, on the demand side, EDP Distribuição (EDPD) will, as the regulated retailer, take over the function of procuring energy for the regulated market, which currently accounts for 90% of the consumption in Portugal. In the absence of special rules regulating the purchasing behaviour of EDPD - the dominant retailer (see below section on retail supply of electricity) -, the latter will, in all likelihood, purchase electricity from its own generating company (EDP) through intra-group bilateral agreements.
300. In their replies to the statement of objections, the parties argue that, under the current regulatory framework (Decree-Law 185/2003): "*Article 14 paragraph 5 (in relation with paragraphs 1 and 2) obliges the holder of the licence in high and medium voltage (i.e. EDPD) to acquire in the (to be created) organised wholesale market a quantity of energy equivalent to the energy previously acquired by the concession holder of the RNT (i.e. REN) under the PPAs. As a result, EDPD will be able to conclude bilateral contracts only for the proportion of its demand that cannot be sourced in the market.*"²²⁰ A close reading of the decree-law does not support the Parties' conclusion: Article 14 of the decree law is entitled "transitory functioning" and applies only to the transitory period during which REN's role as a single buyer would have ended but a few PPAs would not have been terminated yet. In this case, Article 14, paragraph 5, (in conjunction with paragraphs 1 and 2) would only oblige EDP to purchase from the wholesale market volumes of electricity equivalent to the volumes provided in those PPAs which would not have been terminated at that time until their abolition. This constraint (that the parties present as permanent) is therefore

²¹⁸ See also Commission Communication relating to the methodology for analysing State aid linked to stranded costs (http://europa.eu.int/comm/competition/state_aid/legislation/stranded_costs/pt.pdf), communicated to Member States by letter ref. SG(2001) D/290869 of 6.8.2001

²¹⁹ On the duty to take account of the effects of state aids for the purpose of the assessment of a concentration, see Case T-156/98, RJB Mining v Commission, [2001] ECR II-337.

²²⁰ EDP's reply to the SO, 28.10.2004, p.26

only transitory, very limited in scope²²¹ and the conditions for this constraint to apply are unlikely to be met.

301. As regards the future regulatory framework, the parties argue that “*a similar stipulation for regulated retailers*” is contained in Article 3 of the International Agreement signed on 1 October 2004 by Portugal and Spain. However, Article 3 of the 1 October 2004 International Agreement does not contain such a provision as it only lists the entities which will be authorised to buy electricity on the MIBEL. It does not contain any obligation for the regulated retailer to buy a certain volume of power on the MIBEL. Therefore, the Commission finds that there is no ground for the parties’ contention aiming to show that EDP will be prevented from enjoying the advantages identified during the investigation and described above.

The addition of TER is significant in EDP’s portfolio

302. On the supply side, account must also be taken of the new capacities that will be added in the near future. The most important addition will be due to EDP’s CCGT plant “TER”, whose third block will come on-stream in 2006 and which will have a total installed capacity of [1,000 – 1,500]* MW. TER will be able to produce 8000 GWh/year, which amounts to nearly 20% of the total current electricity consumption in Portugal²²². In addition to the size of the generation capacity, this plant also confers to EDP a strategic advantage on the market given that it is located in the middle zone of the merit order, i.e. at a level of power demand which occurs quite often. As a result, TER is likely to be the marginal plant and thus to set the price on the market during a significant part of the time. In addition, TER is more efficient than the other CCGT in Portugal (Turbogás) and, consequently, comes earlier in the Portuguese merit order. [...] * TER is therefore likely to be dispatched more often than Turbogás and, possibly, instead of Turbogás (as compared with today’s situation). TER will thus negatively impact on Turbogás’ market shares. In that respect, EDP’s internal documents confirm that, thanks to TER, EDP will indeed further consolidate its leadership in terms of generation capacity and market shares as well as its marginal price-setting capabilities on the Portuguese market. EDP thus mentions [...] *²²³. It also mentions the fact that [...] *²²⁴
303. According to the parties’ reply to the statement of objections, the fact that TER is more efficient than Turbogás does not provide a significant advantage to EDP. They argue that, since TER comes earlier in the merit order, Turbogás will be the plant setting the marginal price in the market.
304. However, this argument does not take account of the fact that, given that TER is more efficient, Turbogás will be dispatched less often than up to now. Furthermore, whenever Turbogás is not dispatched, TER is likely to set the price as it is located in the middle zone of the merit order. In addition the parties do not dispute that, as explained above, thanks to its generation mix that allows it to address the base load demand as well as the peak demand, EDP already operated the power plant that set the

²²¹ The only PPAs which do not depend on EDP to be terminated are those of Tejo Energia and Turbogás. Therefore, in the (very unlikely) event where the two latter PPAs would not have been remain unterminated while MIBEL has started operations, EDPD would be not be constraint to buy on the pool for more than [70-80]% of its needs.

²²² Form CO, page 81.

²²³ [...]

²²⁴ [...]

marginal price of electricity in 60 to 80% of the time between 2001 and 2003, i.e. at a period where TER was not yet operational.

Competitors' projects are highly uncertain and EDP has significant influence over one of them

305. As regards new generation capacities to be built by third parties, the parties have indicated²²⁵ that there would be three other CCGTs in Portugal by 2007: a first in Pego to be operated by Tejo Energia, a second in Figueira da Foz to be operated by Iberdrola and a third in Sinès to be operated by Gas Natural. If these CCGTs were to start operations in 2007, EDP would not face additional competitive constraints for the coming two to three years. However, the Commission's in-depth investigation has confirmed in addition that many uncertainties remain as to whether any of these three projects will effectively be operational in the future or, at least, in 2007.

306. First, as regards Iberdrola, the project of a new CCGT is far from being certain. It is true that Iberdrola has confirmed "*plans to start operating a 2x400MW CCGT in Figueira da Foz in the second half of 2007*"²²⁶. However, the achievement of these plans, in Iberdrola's words, is only envisaged "*if market conditions are satisfactory (regulatory and administrative process, level playing field as to pricing of electricity, etc.)*."²²⁷ Iberdrola's project still depends on two important factors: (i) the timely obtaining of the necessary permits depending on the attitude of the central authorities and (ii) the conditions on the market following the adoption of a compensation scheme in Portugal.

307. Regarding the first of these, Iberdrola explains that:

*"As to the administrative process, the local authorities are very cooperative as the CCGT represent a big investment locally. However, Iberdrola is facing big problems with the central authorities [...]".*²²⁸

308. Regarding the second factor, Iberdrola's position is as follows:

*"As to the conditions of pricing (stranded costs mechanisms), Iberdrola considers that CTCs in Spain have created huge distortions in the electricity market.. [...]** *If a similar system were to be applied in Portugal, MIBEL would be a trading system between two distorted markets. The distortion of prices due to CTCs has a strong impact on whether to invest. If the Portuguese compensation scheme is similar to that applied in Spain, it can have a big impact on future competition in Portugal. Indeed, such a system enables the main player, i.e. EDP, to price at level low enough, and without losing money, so as to throw future competitors (which cannot benefit from the scheme) out of the market. In Spain, Iberdrola is short of CTCs and could not use it to compensate the losses in Portugal. If a scheme similar to the Spanish one is applied in Portugal, the impact on the competition will be very important and EDP will have opportunities to act in a strategic way. As a result, Iberdrola will have to seriously reconsider its development in Portugal, both at the level of the CCGT as well as imports. Iberdrola will have to assess whether these investments are still relevant in*

²²⁵ Form CO, pages 13 and 78.

²²⁶ Minutes of meeting with Iberdrola, 08.09.2004.

²²⁷ Minutes of meeting with Iberdrola, 08.09.2004.

²²⁸ Minutes of meeting with Iberdrola, 08.09.2004.

this new environment. Iberdrola cannot afford to invest in Portugal if it ends up being stuck with not enough sales to recoup its investments”²²⁹.

309. In their replies to the statement of objections, the parties argue that Iberdrola decided to invest in a new CCGT after the decision to terminate the PPAs and to introduce a compensation scheme was taken. However, this argument does not take account of the fact that the modalities of the projected compensation scheme were not yet known by operators like Iberdrola before the adoption of the Commission decision of 22 September 2004 not to raise objections against such a scheme. In addition, contrary to what the parties imply, Iberdrola does consider²³⁰ that the compensation scheme affects the competitiveness of new entrants and should be considered as a barrier to entry. Therefore, it is far from certain that Iberdrola will actually decide to build a new CCGT in Portugal by 2007.
310. Secondly, as regards the CCGT to be developed by Tejo Energia in Pego (Tejo II), the Commission’s in-depth investigation has not confirmed that there is a final decision to build and operate such a plant, even less that such a plant would be operational in 2007. Indeed, the project to build a new CCGT remains on hold because of conflicting views amongst other shareholders and because of uncertainties as regards the financing²³¹.
311. [...]*
312. In their replies to the statement of objections, the parties do not dispute that there is no final decision as to the construction of this new CCGT.
313. EDP only submits that it will not be in a position to block such an investment decision from being adopted. [...] ²³²
314. [...]*
315. [...]*
316. [...]*
317. Thirdly, as regards Gas Natural, this company explained to the Commission that “*the starting of the CCGT was foreseen for 2007/2008 but there is a substantial risk that it could be delayed [...]**”²³³.
318. The above thus clearly shows that the realisation of the three new alleged CCGTs is still very doubtful and, anyway, that there are substantial uncertainties as to the timing of their possible start of operations. In addition, several studies do not forecast

²²⁹ Minutes of meeting with Iberdrola, 8.9.2004.

²³⁰ Minutes of meeting with Iberdrola, 8.9.2004.

²³¹ See the agreed minutes of a meeting with International Power of 19.9.2004, where is explained that: “*Discussions are ongoing with [...] in order to determine how the project may be structured and which entities are willing to bear market risk. [...] appear willing to take merchant risk (i.e. to use this CCGT to supply directly the electricity wholesale market), but not [...], which wants the CCGT to operate under a tolling agreement so that it does not bear merchant risk on its potential investment. [...] wants this CCGT to work like [...] and to provide a guaranteed return on investment. Contrary to [...] and [...], [...] has not demonstrated a real interest in developing the generation capacities of [...]. There is a general consensus among the [...] that the project has competitive advantages over alternative potential green field developments but more information is needed about what the liberalised market will look like (market implementation) before taking a decision on the project. Right now there are too many uncertainties*”.

²³² [...]

²³³ See agreed minutes of the meeting with Gas Natural of 27.08.2004.

additional CCGTs (but TER): REN/REE’s study “*Prevision conjunta de la cobertura*” of December 2003 does not forecast that any new CCGT apart from TER’s three units will be needed to meet the demand until 2008. Similarly, according to ENI: the “*Plano de Expansão do Sistema Electroprodutor (DGE, 2002) estimates that, in order to satisfy the growing Portuguese electrical demand in the period 2008-2012, [only] the following gas fired generation capacity will be needed: (i) for 2009–2010, 2 gas turbine groups of 160 MW each, corresponding to a natural gas consumption of 180 Mcm/y [...]**”; and (ii) in 2011, 3 CCGT groups of 400 MW each, corresponding to a natural gas consumption of 1,200 Mcm/y [...]*”²³⁴. In its reply to the statement of objections, EDP does not dispute the assessment contained in this study but only asserts, without further explanation, that it is not an “official” study. The fact remains that these elements further confirm the strong likelihood that no new CCGT will be built by independent competitors in the foreseeable future, or that their construction will be delayed until after 2010.

319. Furthermore, it should also be considered that EDP might take action to delay these projects in many ways, [...]*, for instance by trying to anticipate on its competitors moves by speeding up a new project for the construction of its second CCGT²³⁵. In this respect it should be noted that [...]*²³⁶. This has not been disputed by EDP in its reply to the statement of objections. On the contrary, EDP confirmed to the Commission²³⁷ that [...]*
320. Finally, even if CCGTs were to be operational in 2007/2008, which is not likely, EDP’s dominant position would not be affected given the relative size of its generation portfolio and its generation mix. Indeed, if all units of these new CCGTs were to be operational simultaneously in 2008, they would account only for 14% of the installed capacity in 2008²³⁸. Besides EDP would keep enjoying its hydro and coal plants²³⁹ which allow it to set the price at hours when CCGTs are not the marginal plants.

*Capacity agreements with competitors risk having a stifling impact on competitive market behaviour*²⁴⁰

321. Apart from these projects, the investigation carried out by the Commission has shown that the main electricity player in Spain, Endesa, is not likely to compete aggressively against EDP. Indeed, the two electricity incumbents are already jointly active in several projects in Portugal: Tejo Energia (coal plant) and possibly a future CCGT, and Portgás (Local Distribution Company). [...]*²⁴¹
322. [...]*²⁴²²⁴³²⁴⁴²⁴⁵
323. [...]*²⁴⁶

²³⁴ ENI’s answer to the Commission’s information request of 26/7/04.

²³⁵ [...]

²³⁶ [...]

²³⁷ Reply to the Commission’s Article 11 request of 26.10.2004.

²³⁸ According to REN/REE, installed capacity in 2008 with no additional CCGT will be of 15GW. 3x2 400MW CCGTs would account for 2.4GW and bring the total installed capacity to 17.4GW.

²³⁹ [...]

²⁴⁰ This is irrespective of their compatibility with competition law.

²⁴¹ [...]

²⁴² [...]

²⁴³ [...]

²⁴⁴ [...]

²⁴⁵ [...]

324. In response to the above-mentioned findings (see paragraphs 321 to 323) according to which [...] EDP only indicates, in its reply to the statement of objections, that the observations contained in [...]*, do not necessarily represent its views. In addition, as indicated above, [...]*

Demand will grow but it is very uncertain whether this will lead to the building of three new CCGTs before 2010

325. According to Iberdrola, “*there is room for 3 CCGTs in the years to come.*”²⁴⁷ However, this opinion is contradicted [...] in which it is stated that [...] ²⁴⁸, and the installed capacity forecast by the electricity grid operator REN and the Portuguese General Directorate for Energy (“DGE”). Indeed, in their joint study “*Previsión conjunta de la cobertura de la demanda – Periodo 2004-2012*”, published in December 2003, REN and REE forecast that the installed capacity of conventional thermal plants in Portugal (including CCGTs, coal and fuel-oil plants) will increase from 5507MW in 2004 to 6313MW in 2012, that is, only by 800MW, which corresponds to the two units of TER which have not been commercially launched yet. REN/REE does not foresee any mismatch between the installed capacity and the peak demand in Portugal up to 2012 even though only one additional CCGT (namely TER) will be built, the installed capacity²⁴⁹ being 14% to 20% higher than the peak demand depending on the year. Similarly, the DGE forecast²⁵⁰ that the consumption of gas for CCGTs will increase by 1.5bcm between 2002 and 2011, with an increase between 2002 and 2011 of roughly 1.2bcm. Given that this is the total amount of gas that will be consumed on average by the three units of TER, it appears clear that the Portuguese ministry in charge of energetic questions does not expect other CCGTs to be built before 2011.

326. [...]*

327. The construction of additional CCGTs by independent competitors seems all the more unlikely in that, as indicated in paragraph 123, [...]*

328. Finally, as already mentioned, the CMEC scheme is likely to delay the retirement of older, more inefficient plants and thereby delay the demand for new plants (which are likely to be CCGT plants).

329. In their replies to the SO, the parties argue that, in its assessment of the need for new CCGTs, the Commission has not taken account (i) of the phasing out of fuel oil power plants and the reduction of the utilisation of the coal power plants as well as (ii) of the reserve of CO2 emission allowances set up in the Portuguese 2005-2007 NAP.

330. As regards the former argument, the investigation carried out by the Commission has showed that the CMECs, by compensating the least efficient plants, will maintain their profitability even though underlying costs increase, thus preventing them from being

246 [...]

247 Minutes of meeting with Iberdrola, 8.9.2004.

248 [...]

249 This ratio refers to the reserve of capacity available, i.e. once power reserves have been removed. It is therefore a conservative figure. See page 25 of the report.

250 [...]

phased out and replaced by more efficient plants. This effect is underlined by the Portuguese and the Spanish regulators themselves²⁵¹.

331. [...]*

Imports will remain insufficient to challenge EDP's dominance

332. Finally, as regards imports expected from Spain in the future, it has already been explained that the projected level of interconnections would not reach a sufficient level in the coming years in order to ensure that EDP cannot exercise market power in Portugal in the future²⁵². As explained by CNE, the Spanish energy regulator: “*Except if interconnections are significantly bigger than what is planned for the coming years, the Portuguese domestic demand cannot be addressed (today and for the years to come) without energy generated by EDP. This means that EDP has the ability, without any constraints coming from other competitors, to let the few independent producers in Portugal generate power, let competitors fully use the interconnections to import electricity and still offer electricity at a very high price and to find it profitable. Given that the demand is extremely inelastic, the demand for electricity would not even be significantly reduced, at least not to an extent sufficient to make it unprofitable for EDP. In the context of the MIBEL, this ability is unaltered and would lead, technically speaking, to market splitting (if such a congestion management rule is retained). In the case of EDP, a part of the imports triggered by such behaviour could be provided by Hidrocantábrico²⁵³, making such behaviour even more profitable.*”²⁵⁴
333. It follows that EDP will remain an unavoidable trading partner in the Portuguese wholesale market, its capacity being necessary to provide the supply needed on the market in order to meet the demand, such dependence being even stronger at times of peak demand²⁵⁵. The combined supply of the rest of the generators, even if the total amount of possible imports were available to EDP's wholesale competitors (which, as the current situation in which EDP is the chief importer shows, is not a likely scenario) will remain insufficient to satisfy demand.
334. For the abovementioned reasons, the Commission therefore concludes that EDP holds a dominant position on the wholesale electricity market and will continue to do so for the foreseeable future.

(b) EDP's dominant position will be strengthened as a result of the merger because of horizontal and non-horizontal effects

b.1) Horizontal effects: removal of a significant potential competitor

335. The proposed operation will strengthen EDP's dominant position on the Portuguese wholesale electricity market since it will eliminate GDP as a significant potential competitor.

²⁵¹ ERSE/CNE, “Comentários da CNE/ERSE às soluções acordadas sobre o mercado ibérico da electricidade”, 19.12.2003

²⁵² See, in particular, Minutes of meeting with REE, mentioned above, on 26.08.2004

²⁵³ EDP owns and controls Hidrocantábrico.

²⁵⁴ Minutes of meeting with CNE, on 07.09.2004

²⁵⁵ See also “Study on electricity and gas markets in Portugal”, Final Report, Cambridge Economic Policy Associates Ltd, for the Autoridade da Concorrência, April 2004, page 40 (http://www.autoridadedaconcorrenca.pt/vImages/CEPA_FinalReport.pdf) showing that the share of the dominant generator in peak demand exceeded 80% in 2003. This increased dependence on the dominant generator in times of peak demand will not change after termination of the PPAs.

Prior to the merger, there were strong incentives for GALP/GDP to enter the wholesale electricity market and to develop as EDP's main competitor

336. All market participants have confirmed that CCGTs, that is, gas-based power plants, are nowadays the most efficient way to produce electricity. The vast majority of the new capacities built over the past years or expected to be built in the foreseeable future are gas-based power plants (apart from nuclear power plants).
337. As explained in a recent study, GDP, through GALP, would be a “*natural competitor to EDP in the generation market in Portugal*”²⁵⁶, in the light of the experience in other Member States. In Spain for example, the main gas utility, Gas Natural, has made a successful entry into the wholesale electricity market with the construction of a number of CCGTs, exploiting its strong position in gas procurement. Gas companies elsewhere in Europe, such as British Gas in the UK (Centrica), have entered this market with success, more specifically in national markets where they already have gas operations.

Respondents' views confirm this strong incentive

338. During the Commission's investigation, respondents active on the supply side have indeed confirmed that GDP would have been very likely to develop activities in the electricity wholesale market in Portugal. For instance, one electricity player active in Portugal underlined that « *In light of the developments that occurred in the UK and in Spain, absent the merger, the potential entry of GDP/Transgas in the electricity wholesale market would represent a sound risk management strategy to back any potential expansion into electricity retail* »²⁵⁷ Another electricity player active in Portugal also considered that “*the acquisition prevents the entry of a potential competitor in the electricity market – GDP (as was the case in Spain and the UK)*”²⁵⁸.
339. These views were shared by other respondents, who referred to the fact that it is common market behaviour to diversify the gas activities through a stronger presence in the electricity market. In particular, CNE, the Spanish regulator, underlined that “*Gas and electricity incumbents have important advantages in entering each other markets and are therefore the most probable and better equipped potential competitors*”²⁵⁹ On the demand side, respondents also confirmed that a natural gas operator as GDP would have been well placed to enter the electricity wholesale market.

Strong economic rationale for entry

340. GDP's entry in the wholesale market absent the merger, either on its own or even in cooperation with other electricity suppliers, would indeed have been rational and highly likely in view of its ability to rely on a secured gas supply in Portugal. Considering the fact that gas-fired power plants (CCGTs) now constitute the most common way of generating new electricity, for both economic and environmental reasons, such a factor would be a decisive element for the incumbent gas supplier when considering the prospects of a successful and sustainable entry on the market. GDP could have relied, in particular, on the experience gathered by ENI in Italy, where the gas company has entered electricity generation through CCGTs and for which the

²⁵⁶ “Study on electricity and gas markets in Portugal”, Final Report, Cambridge Economic Policy Associates Ltd, for the Autoridade da Concorrência, April 2004, page 38.

²⁵⁷ Reply by [...] to the Commission's Art. 11 letter on 03.9.2004

²⁵⁸ Reply by [...] to the Commission's Art. 11 letter on 20.7.2004

²⁵⁹ Minutes of meeting with CNE on 7.9.2004

involvement of the group in power generation projects appears to be a strategic priority²⁶⁰

341. GDP's access to large quantities of gas at very favourable economic conditions would have allowed GDP to operate a CCGT with low variable costs as compared with TER or Turbogás (which GDP supplies with gas). As a result, GDP's CCGT would have been located before TER and Turbogás in the Portuguese power plant merit order and would have been likely to be dispatched more often than Turbogás and TER.

Rationale for entry in wholesale is aligned with rationale for entry in retail

342. In view of the Spanish experience, CNE confirmed that GDP would have been the most likely and effective potential entrant on the electricity wholesale market mainly due to its privileged access to the gas, which is the most important input in the production of electricity with the modern CCGT technology. In particular, CNE underlined that “*gas incumbents [...] have direct access to gas to be used for electricity production in CCGTs and they are very well hedged (this is critical as CCGTs are more and more used and as it is not easy for newcomers to get gas for electricity production)*”²⁶¹.
343. The Spanish gas incumbent also explained that there were four main reasons for its entry in the national electricity markets. As far as the wholesale electricity market is concerned, it explained that “*it wanted to gain electricity clients to compensate the foreseeable reduction of its market shares in the gas markets after the liberalisation of this sector*”, that “*it could use its CCGTs as “virtual gas storages” (if it had gas in excess, it could use it in the CCGTs)*” and that, if it “*wanted to enter the retail electricity market, it had to operate as well in the generation and wholesale of electricity to hedge the risk of an increase of the price of electricity in the pool: if this price went up a lot, it would have lost money in the retail activity (where prices are constrained by the regulated tariffs), but would have gained more in the wholesale market*”²⁶².
344. The in-depth investigation thus confirms that GDP had strong incentives to enter the wholesale electricity market but for the merger and was likely to grow into an effective competitive force due to the various incumbency advantages that it could rely on as the major gas supplier in Portugal.

It is very likely that, absent the merger, GALP/GDP would have successfully entered the wholesale electricity market

345. Several elements gathered during the Commission's investigation show that, prior to the announcement of the merger, GDP, through GALP, would have actually entered the wholesale electricity market.

GALP Power's activities prove an interest in electricity

346. First, it is worth recalling that, prior to the announcement of the merger, GALP had already set up a subsidiary called GALP Power active in electricity in Portugal.

²⁶⁰ [...]

²⁶¹ Minutes of meeting with CNE, 14.9.2004.

²⁶² Minutes of meeting with Gas Natural of 27.8.2004.

347. In particular, as early as 2000, Galp Power had already started operating cogeneration plants²⁶³, thereby making its entry in the wholesale electricity market all the more credible absent the merger. [...] ^{*264}.

[...]*

348. [...]*

349. [...] ^{*265 266,267}.

350. [...] ^{*268}

351. [...] ^{*269}

352. [...] ^{* 270}

353. [...] ^{*271}

354. [...]*

355. [...]*

356. [...]*

Parties' replies to the statement of objections

357. In its reply to the statement of objections, EDP does not dispute that there are strong incentives for a gas incumbent such as GDP to enter the electricity markets. However, EDP submits that the Commission has failed to consider two disincentives for GDP to enter the electricity wholesale market absent the merger, namely “the scope for retaliation” from EDP by entering into the gas market, and GDP’s existing financial commitments in the gas market.

358. These arguments cannot be accepted for the following reasons.

359. First, EDP’s submission does not take account of the evidence mentioned above showing that Galp not only had already started entering the electricity market through its operation of cogeneration plants but was actually planning to [...]*. EDP’s argument that GDP could have had an incentive to maintain what EDP considers the “current equilibrium” in order to avoid EDP’s entry is also directly contradicted by the fact that EDP, for its part, has already entered the gas market prior to the merger, in particular through Portgás. This evidence confirms that entry into their respective markets is a dominant strategy and suggests that the “current or no-entry equilibrium” cannot be sustained in the absence of an explicit agreement which in itself is to be considered anti-competitive.

360. Secondly, it is important to note that ENI, in its reply to the statement of objections, does not dispute the Commission’s findings (see paragraphs 335-**Error! Reference**

²⁶³ In the year 2000, GALP Power entered the cogeneration market, with a share in two projects: a 44MW power station for Solvay Portugal (Póvoa de Santa Iria) and another 30 MW power station at the Uniteca industrial plant (Carricho - Pombal).

²⁶⁴ [...]

²⁶⁵ [...]

²⁶⁶ [...]

²⁶⁷ [...]

²⁶⁸ [...]

²⁶⁹ [...]

²⁷⁰ [...]

²⁷¹ [...]

source not found.), based in particular on [...] (see paragraphs **Error! Reference source not found.-Error! Reference source not found.**).

361. Finally, on the argument relating to GDP's financial commitments in the gas market, the Commission considers that it is not evident why GDP should not have been able to raise the necessary financial means, through loans or an increase in share capital, for a financially promising entry into electricity markets.

Conclusion on GDP incentives to enter and plans of entry

362. [...] For the reasons already stated above, GDP would indeed have enjoyed strong strategic advantages by comparison to foreign companies willing to enter the Portuguese market such as the ownership of important gas facilities located in the same area allowing a direct, flexible and economical access to gas, [...], and – as will be shown below (see paragraphs 450 - 473) – a very good position to enter at the same time also the electricity retail market.
363. All these elements confirm that the proposed merger will therefore enable EDP to prevent entry of an important – and even the most timely, likely and effective - potential competitor, as a result of which its dominant position in the wholesale electricity market will be strengthened.
364. For this reason, the Commission has come to the view that the concentration as notified will strengthen EDP's dominant position in the wholesale electricity market in Portugal as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

b.2) Non-horizontal effects

365. As confirmed by the parties and the Commission's investigation, gas is the most effective and common input to produce additional electricity nowadays in Europe, using CCGTs. For this reason, the project of introduction of natural gas in Portugal associated the CCGTs from the beginning²⁷².
366. By allowing EDP to acquire the supplier of the main input used for the production of electricity, and hence to integrate upstream with the only supplier of natural gas in Portugal, the operation is likely to change immediately and in the near future, the conditions of competition on the wholesale market and to result in the strengthening of EDP's dominant position.
367. It must be underlined, in this respect, that EDP's actual competitors (or actual competitors immediately after termination of the PPAs) in the Portuguese wholesale market are not vertically integrated in Portugal. Similarly, Endesa and Iberdrola, [...], are not vertically integrated with a gas supplier active in Portugal. In contrast to those firms, EDP, through the acquisition of GDP's position in gas, will thus secure the supply of an essential input for electricity production and, consequently, will immediately hold a significant structural advantage compared to other (actual or potential) electricity generators in Portugal with the incentive to use such advantage to raise the costs of existing and potential rivals as explained below.

²⁷² Form CO, page 77.

1. The concentration will give the merged entity access to proprietary information about its competitors

Access to gas costs of current competitors

368. After the merger, EDP, as a supplier of natural gas, will immediately be in a position to know the gas costs of its main competitor on the electricity market, Turbogás. Since natural gas consumption represents one of the main production costs of CCGTs (around 70% of the variable costs), the operation will substantially increase, for the benefit of EDP only, the transparency of costs of its competitor. In particular, even if EDP were to have access to the price indexation formulae set in the gas contracts of its competitors (which are usually indexed to a basket of oil products and other transparent factors such as GDP) only once after the merger, this would allow EDP to know the movement of variable costs to Turbogás throughout the duration of the gas supply contract (in general 20 years), just by monitoring the price of the relevant basket of goods and other factors referred to in the formula. EDP will therefore obtain a very important advantage over its main actual competitor. (The parties underlined that: *“It should be noted that EDP currently has no information about Turbogás’ gas prices as the contract in that respect is held by REN. Even on the assumption that the contract is transferred to Turbogás it is still likely that, absent the merger, EDP, as a minority shareholder, would continue to have no detailed knowledge about pricing formulae in this contract. The merger would thus give EDP important additional information on the Turbogás variable costs.”*) Therefore, the access to such information at any point in time further to the merger is likely to have irreparable consequences over a long period of time.

Access to gas nominations of current competitors

369. Further to the merger, EDP will also have access to the daily gas nominations of Turbogás (and of other CCGTs possibly supplied by GDP in the future), that is the information, given one day in advance, about the volume of gas that the CCGT plans to consume on an hourly basis. As a result, EDP will be able to know in advance the pattern of power production planned by Turbogás for the following day. This concern was identified early during the Commission’s investigation by several market players active in either gas and/or electricity markets. One of them explained that *“as the other producers will have to communicate the forecast of the gas they need to operate the plant, EDP will be in the position to know how much electricity its competitors will put on the market at a given moment as well as its operational costs. All of that can have a very detrimental effect to competition”*²⁷³. This is also confirmed by Shell: *“Knowing the daily nomination of a competing CCGT gives a valuable insight into likely supply/demand balance in the various hours of the day ahead and thus into the likely shortfalls to be covered in the intra-daily markets, therefore conferring an unfair advantage as it enables a better informed bidding behaviour”*²⁷⁴. On the same lines, ENEL stressed: *“When a company has access to the daily nomination of gas of a competing CCGT, obviously this company has access to extra information about the strategy of the agent in the market. Knowing the daily amount of gas consumption of a competing CCGT permits the company to know a lot about the kind of bids that this*

²⁷³ Reply of [...] to the Commission’s Article 11 request of 20.7.2004.

²⁷⁴ Shell’s reply to the Commission’s Article 11 request of 17.9.2004

*competitor is going to make to the market, the effective constraints that this agent has to sell the electricity and gives the company a lot of advantage over its competitors*²⁷⁵.

370. This situation can be observed in Spain. According to Iberdrola: *“In Spain, Hidrocarbónico and Endesa are supplied with gas by Gas Natural (historical choice when launched CCGTs). This allows Gas Natural to know the daily consumption of gas of the concerned CCGT and thus their level of production. However, Gas Natural holds only 5% of the [electricity] market. It can therefore not draw significant benefits from this information, as its margin of manoeuvre to influence prices in the market is very limited. In Portugal, the situation is quite different*²⁷⁶.
371. Indeed, in Portugal the situation is quite different: the beneficiary of this strategic information is the dominant player, EDP, and Turbogás, about which EDP will obtain this information, is the only remaining power generator in Portugal whose daily levels of production is not already known by EDP (the other power generator, Tejo Energia, operates a coal plant which is used as base load and runs every hour at the same level). More precisely, as was explained by CEPSA: *“If the incumbent had the planned running profile of most of the capacity that it does not control, it could programme its own generation (with different fuels that could provide a more competitive “generation mix price”) either to maximise its income or to minimise the income of its competitors.*²⁷⁷
372. The advantage that EDP will be able to draw from this information is also significant because daily power generation is very volatile. In particular, Turbogás, contrary to Tejo Energia, runs at maximum capacity only a limited proportion of the time: for instance in 2003, [...]”²⁷⁸. Knowing, for instance, that Turbogás does not plan to generate power at a certain time of the following day, EDP will therefore be in a position to raise its prices above Turbogás’ variable costs with no fear of losing sales to Turbogás.

Access to similar information on future competitors

373. Subsequently, EDP will also hold these significant advantages in the future vis-à-vis other potential competitors supplied by GDP, if and when new CCGTs are operated in Portugal. This, in turn, is likely to constitute a significant deterrent for certain firms willing to enter the Portuguese market as long as there are no effective and economic alternatives to GDP.

Replies to the statement of objections

374. In their replies to the statement of objections, the parties do not dispute the Commission’s finding that, as a result of the merger, EDP will immediately be in a position to know the gas costs of its competitor (paragraph 368).
375. As regards gas nominations, the parties do not dispute either that EDP would have access to such information following the merger (paragraphs 369-372). However, EDP considers that this information does not constitute “sensitive information” unless the supply contract obliges the client to provide real time information. In this respect, EDP submits that gas nominations do not “necessarily” reflect the pattern of actual generation because a CCGT enjoys some flexibility in its gas consumption.

²⁷⁵ ENEL’s reply to the Commission’s Article 11 request of 17.9.2004

²⁷⁶ Minutes of meeting with Iberdrola on 8.9.2004

²⁷⁷ CEPSA’s reply to the Commission’s Article 11 request of 17.9.2004

²⁷⁸ [...]

376. The Commission does not share this view. Indeed, even though a plant generates what it considers necessary in view of the real-time price changes during the day, knowing the daily gas nomination of competitors confers a significant advantage as it enables to have extra information on the likely amount of electricity that a plant will put on the market the following day and, in particular, on the maximum amount of electricity that it will be able to generate.
377. In addition, contrary to EDP's submission, the in-depth investigation shows that competitors largely share the view that access to daily gas nominations of a competing CCGT confers a significant advantage (see extracts above). As regards the opinion of Gas Natural, it does not confirm either EDP's submission that information on daily gas nominations is not "sensitive". In this respect, EDP obviously fails to quote Gas Natural's view according to which "*in a scenario whereby a power plant declares itself unavailable, it informs the operator of the electricity system (REE) as well as the operator of the gas networks (Enagas). Having knowledge of such declarations implies a competitive advantage over the others because in real time, and also in the short term, this information can be very important for their offers as it allows to take advantage of the withdrawal of that amount of power from the supply curve, or even to take advantage of its rent position, in case the unavailability of such power plant means an obligation to dispatch others due to such restrictions*"²⁷⁹. In the same vein, Gas Natural also adds that "*Having said this, if the operator of the gas system has generation assets, we might be in the case of specific scenarios whereby the knowledge on the gas nominations would imply a competitive advantage vis-à-vis the other players*"²⁸⁰

Conclusion on access to proprietary information

378. It follows from these observations that, as a result of the merger, EDP's dominant position on the wholesale electricity market will be strengthened since the merged entity will be armed with knowledge of its actual competitors' input costs and daily needs in gas and will be able to price in such a way so as to foreclose its rivals. Such structural advantage will also strengthen EDP's dominant position as it is likely to further deter or delay entries of potential competitors willing to operate new CCGTs through supplies of gas by GDP.
379. For these reasons, the Commission has come to the view that the concentration as notified will strengthen EDP's dominant position in the wholesale electricity market in Portugal as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

2. EDP would have privileged and preferential access to natural gas resources available in Portugal

380. Further to the proposed transaction, EDP will have the ability and the incentive to maintain a privileged and preferential access to natural gas to the detriment of companies actually or potentially involved in electricity generation.
381. The parties submit that, even if EDP post transaction will have privileged access to GDP's natural gas for power generation purposes, power producers will not be affected by the transaction because they will enjoy access to a large number of alternative

²⁷⁹ Gas Natural's reply to question 7 of the Commission's Article 11 request dated 17.9.2004.

²⁸⁰ Gas Natural's reply to question 7 of the Commission's Article 11 request dated 17.9.2004.

natural gas suppliers²⁸¹. This view presupposes that there will be sufficient available capacity in order for a competing gas supplier to effectively enter the Portuguese gas market in due time. However, the Commission finds that after the opening of the gas markets, even if very effective rules on third parties were adopted, GDP/Transgás can significantly limit access to the Portuguese gas network through the two existing entry points: the Sinès LNG terminal and the international pipeline entering Portugal at Campo Maior²⁸².

382. Such practices are all the more likely that they could appear to be objectively justified on certain regulatory or technical grounds (for example, booking of capacities, bottlenecks, etc.), or remain undetected in time. In this respect, it should be noted that, in response to a Commission's information request, the Portuguese regulator (ERSE) confirmed that, even if TPA rules are adopted in the future, it "*cannot affirm that any discriminatory practice will be detected in time if there will not be ownership unbundling*"²⁸³ of the gas infrastructures²⁸³.
383. In addition, further to the merger EDP may be able to have some influence on the management of the high-pressure gas network: (i) in the short term, EDP will jointly control Transgás (including the gas network) for a temporary²⁸⁴ period which may last up to [...] months. During this period, EDP may have a strong influence on the strategy and management of the network. This may also provide EDP with a deep insight into the network operating features from which EDP may later on draw advantages; (ii) in the long term, REN will operate the high-pressure gas network as a result of the merger. Apart from the Portuguese government, EDP is the main shareholder of REN of which it holds a 30% share. Such level of shareholding in the gas network operator has been prohibited by law in Spain: no company is allowed to hold more than 5% of shares. EDP has publicly stated²⁸⁵ that it planned to reduce its share in REN in the future. However, the Commission has no evidence that EDP will actually do it and that the reduction foreseen by EDP will be sufficient to reduce EDP's influence on REN.

GDP's international pipeline

384. The first existing entry point in Portugal is the pipeline which goes from Algeria to Portugal through Morocco and Spain. This pipeline enters Portugal at Campo Maior / Badajoz, runs through Portugal and exits Portugal in Braga to supply Galicia. The capacity rights to transport gas on this pipeline are shared among GDP (Transgás) and

²⁸¹ Form CO, page 128.

²⁸² The international pipeline also connects Portugal and Spain in the northern part of Portugal, between Braga and Tuy. However, this point is used as an exit point. The parties argued that this point should be taken into account as allowing third parties to import gas into Portugal. The Commission does not share this view because (i) significant investments would be required to use this point as a physical entry point, (ii) Enagás has confirmed that they will keep using it as an exit point in the future (even after the launch of El Ferrol LNG terminal), (iii) the pipe has a very low throughput at this level and (iv) the LNG terminal which is the closest is El Ferrol LNG terminal, which is still under construction. In addition, Enagás has emphasized in its reply to the Commission's market test of the parties' remedy proposals that the feasibility of the commercial or physical reversal of the flow depends on an additional agreement between the Portuguese and Spanish TSOs which is not in place.

²⁸³ See ERSE's response to question 25 of the Commission's questionnaire of 28.7.2004.

²⁸⁴ The Commission also has to assess intermediate steps in the evolution of the market structure, in particular as a situation, even though temporary, may have a strong detrimental impact on competition and, possibly, long-lasting effects.

²⁸⁵ See EDP's 2003 annual report

Enagás, the Spanish gas Network operator, which uses this section of the pipeline for the supply of Galicia though Portuguese territory.

385. A large part of the available entry capacity²⁸⁶ is already reserved by Transgás. Indeed, on a total available capacity of [...] *²⁸⁷ are already reserved by Transgás. Furthermore, before the adoption of third parties' rules, even a larger capacity could be booked by this company, [...] *²⁸⁸). In its reply to the statement of objections, ENI argues that the transport of a gas volume higher than the reserved capacity was due to exceptional circumstances, namely the need to import LNG through the import pipeline in Spain because of the unavailability of the Sinés terminal.
386. However, it remains that Transgás' already considerable reserved capacity could still be further increased before the adoption of national rules on third party's access, thereby depriving these rules of practical effects. [...] *²⁸⁹
387. It has to be noted that, even though GDP has now the Sinès LNG terminal at its disposal to import gas, GDP's forecasts do not foresee that GDP will reduce the quantity of its imports from Algeria. On the contrary, the merged entity will be in a position to use its pipeline at full capacity in order to prevent competitors to use any freed capacity. Such a strategy would be rational for the merged entity, as this pipeline is crucial to control competition in Portugal: it is the only infrastructure which would allow a Spanish competitor to import gas into Portugal when gas is available in the Spanish gas network. Besides, its daily use is more flexible than an LNG terminal. [...] *²⁹⁰.
388. These elements confirm that GDP/Transgás therefore effectively controls all the available entry capacity through the international pipeline.
389. In their replies to the statement of objections, the parties argue that, in any event, Enagás could, in the future, free the transit capacity currently reserved to supply gas in Galicia. The Commission does not share this view. Indeed, it remains very unlikely that Enagás will stop using its capacity to supply Galicia in the future, even once an LNG terminal will be realised in Galicia, given the transmission costs through Portugal that it would have to pay in any case due to its contractual obligations²⁹¹.
390. In light of this evidence, it is plain that, even if TPA is applied, there is currently not enough free capacity for third parties to import gas on a permanent basis and with a minimum of certainty as to the level of gas they will be able to import. As was explained by an energy player in the Iberian peninsula: *“every time capacity in the Algerian pipeline has been requested it has been replied that there was none available.*

²⁸⁶ In this context, the available entry capacity is considered as the total technical capacity of the pipeline minus the capacity which is allocated to Enagas for the supply of Galicia though the Portuguese territory.

²⁸⁷ As explained in the previous footnote, this capacity is obtained subtracting Enagas' reserved capacity ([...] m³/y of gas) from the total technical capacity of the pipeline (3.679 m³/y).

²⁸⁸ [...]

²⁸⁹ [...]

²⁹⁰ [...]

²⁹¹ In this regard, it should be noted that a “senior manager of Enagas expressed the opinion that, as Enagas has to pay for the transmission of gas through Portugal, probably gas will always go through Portugal even once the Reganosa LNG terminal starts operating” (see Agreed minutes of the meeting of 26.8.2004 with Enagas). (The Reganosa terminal referred to here is the terminal being built near El Ferrol in Galicia.)

This may explain why GDF and other operators have decided to launch a project for a second pipeline linking Spain to Algeria."²⁹²

GDP's Sinès LNG terminal

391. The LNG terminal located in Sinès is the only one in Portugal. It was launched at the beginning of 2004 and is owned and operated by GDP (through its wholly-owned subsidiary Transgás). Its maximum import capacity is 5.3 bcm p.a. In the absence of liberalisation in the gas sector, so far, no TPA rule has been imposed on the terminal. As a result, third parties who would like to have access to the terminal would have to contact GDP and negotiate specific terms and conditions with the latter.
392. Contrary to the parties' view, the Commission thinks that, irrespective of the rules that will be adopted by the national authorities, GDP/Transgás can significantly limit or impede third parties' access to the terminal.
393. First, the Commission has serious concerns that no sufficient import capacity will be available in the Sinès LNG terminal for competitors independent from ENI and GDP willing to supply gas to actual or potential CCGTs in Portugal. Indeed, several elements indicate that the capacity of the terminal is likely to be almost fully booked by GDP, [...] or subsidiaries thereof, thus making the use of this entry point ineffective for competitors in the future. As was explained by a respondent active in the Iberian Peninsula: "*the terminals are very capital-intensive. For this investment to be recouped, capacity is usually booked well in advance before the terminal is even built*"²⁹³. This capacity already booked will therefore not be available for third parties under third parties' access rules²⁹⁴.
394. So far, as explained above, according to the parties, on a total available capacity of 5.256 Mm³/y, Transgás has already reserved a growing capacity which in [...] will reach [...] Mm³/y ([60-70]% of the total available capacity)²⁹⁵. Transgás' already considerable reserved capacity could also be further increased before the adoption of national rules on third party's access, depriving these rules of practical effect.
395. In this regard it should be noted that this is not only an abstract and remote possibility, but a demonstrable eventuality, given that, as was explained by ENI in response to a Commission's information request, [...] ²⁹⁶.
396. Secondly, the Commission also has serious concerns that, even if a substantial amount of capacity were ultimately made available to competitors, the adoption of TPA rules would not be sufficient to effectively prevent EDP from making access to the terminal more difficult for third parties.
397. More specifically, the regasification activity of an LNG terminal is composed of three main parts which are all inter-dependent and are as many bottlenecks: (i) LNG carrier

²⁹² Minutes of meeting with [...] on 14.9.2004

²⁹³ Minutes of meeting with [...] on 14.9.2004

²⁹⁴ In this respect, Article 21 of the Second Gas Directive (EC/2003/55) states that "Natural gas undertakings may refuse access to the system on the basis of lack of capacity".

²⁹⁵ See the figures sent by the parties the 13.9.2004. However, it should be noted, that, at a very late stage of the procedure (explanatory memorandum of 26.11.2004), ENI specified that the usage factor of the terminal ranges from [...] to [...] and that, therefore, the capacity available for third parties would be lower. Depending on this coefficient, the capacity available will range from below [...] bcm to [...]bcm, only, instead of [...]bcm. As a result, GDP would book from [...] Mcm to [...] Mcm, corresponding to [70%-80%] of the overall capacity of the terminal.

²⁹⁶ [...]

ships have to be unloaded. Time slots have to be booked. Arbitrage between ships and priority rules are then crucial; (ii) LNG could be stored in a storage facility. Storage capacity may be limited, thereby preventing a competitor from unloading or forcing him to inject the gas in the network very rapidly and (iii) the LNG has to be regasified before being injected. There again, the regasification plant has limited capacity which has to be booked in advance.

398. A gas player explains how the operator of an LNG terminal can rely on bottlenecks in order to act to the detriment of competitors despite the existence of TPA rules: *“It is very easy to make the use of a LNG terminal difficult to competitors. This can be done through three possible bottlenecks: (i) delay of cargos -unloading, (ii) storage of LNG; (iii) regasification. [...]”* has currently faced this problem within the U.S. Technical rules could also act as a restriction of the market. A LNG carrier terminal always can set technical constraints that prevent certain LNG carriers to unload. For instance, certain terminals in Europe impose that the LNG carrier holds a classification system and therefore can easily put technical rules – CAP certificate for security reasons. This excludes some Algerian LNG carriers. Similarly, when 2 cargos arrive at the same time, giving priority to one of them can have a significant impact on the player which is delayed (time and extra cost); when (or arguing that) the LNG storage is full, the LNG terminal operator can ask some players who unloaded recently to however asking the market player to consume their gas first, forcing them to inject gas in the network in excess as compared to the consumption of their customers. Ways to play with these three bottlenecks are multi-fold. pipeline transmission congestion during the winter solved it in favour of one company, etc ...”²⁹⁷

399. The fact that TPA rules are not sufficient to guarantee a satisfactory level of access to third parties is underlined by another electricity player: *“It is very rare that TPA rules on LNG terminal work properly: there are too many factors that can be played with in order to prevent effective use by third parties. Most of the LNG terminals are operated by their main user. [...]”* [the respondent] does not know how the alleged spare capacity in the Sinès LNG terminal will be allocated. It might be physically free, but contractually used. The existing of spare capacity does not mean that it is not still risky in practice. There are still terms to be negotiated, for example pricing mechanisms, overall flexibility and allocation (first-come-first-serve-basis or priority serving).”²⁹⁸ As a result, in addition to TPA, specific rules²⁹⁹ have been defined by regulators on a case by case basis in order to help improve the way competitors can use LNG terminals. It may well be that this works as a factor deterring or delaying entry into what is after all a rather small market.

400. [...]”

401. In their replies to the statement of objections, the parties criticise the Commission’s view that the adoption of TPA, in conjunction with the legal unbundling of the terminal, would not be sufficient to effectively prevent EDP from making access to the terminal more difficult for third parties. In particular, they argue, on the one hand, that the Second Gas Directive only requires the adoption of TPA rules and the legal unbundling of the LNG terminals and, on the other hand, that most of the respondents to the Commission’s market test indicated that legal unbundling with regulated TPA would be sufficient to effectively enter the Portuguese gas markets.

²⁹⁷ Minutes of meeting with [...] on 27.8.2004

²⁹⁸ Minutes of meeting with [...] on 14.9.2004

²⁹⁹ For instance, paying for the booked capacity and/or “use-it-or-lose-it” rule

402. However, it should be noted that the provisions of the Second Gas Directive aim at the gradual creation of a common gas market, and, although also aiming at general promotion of competition, do not specifically address competition concerns raised by an individual concentration like the present one. As regards the respondents' views during the Commission's market investigation, they relate to the general regulatory conditions that would be needed to open the Portuguese gas markets, but not to the specific conditions that would be needed to effectively prevent EDP's dominant position being strengthened after the merger, thanks to its privileged access to gas infrastructures owned and operated by GDP.

GDP's Carriço underground storage

403. Further to the merger, EDP will also be in a position to operate GDP's Carriço underground storage. This is the only storage of natural gas available in Portugal (apart from the LNG storage in Sinès which is much smaller). Such a storage is strategic when one wants to operate CCGTs: indeed, to obtain economically interesting gas contracts, CCGTs have usually to face significant take-or-pay (TOP) obligations³⁰⁰. Such obligations impose important constraints on the CCGTs since CCGTs are by nature quite versatile and can be used to address peak demand. As a result, their consumption of gas is very erratic. Such storage allows to mitigate the constraint of the TOP, by storing the TOP quantity of gas when the CCGT is not running at full steam. It therefore provides the CCGT operator with much more flexibility on the electricity generation market and allows obtaining better gas supply conditions since higher levels of TOP can be accepted. [...] ^{301 302}

404. In light of the above, it clearly appears that it is essential for competing power generators operating CCGTs to have access to the flexibility offered by this storage on a non-discriminatory basis. The market investigation confirmed that these access conditions were not sufficient to ensure that competitors will actually fully benefit from the storage, as EDP will be in a position the limit access by arguing about technical issues. [...] ³⁰³.

EDP will enjoy significant advantages in the management of the gas supply

405. Last, several market participants have underlined that, further to the merger, the merged entity will be able to optimise the management of the gas supply to EDP and to its competitors in a way which benefits the former. First of all, EDP will be able to be the first CCGT operator to be aware of any incident relating to gas supply. As a result, it can anticipate and avoid paying high penalties while other competitors may have to pay high penalties because they were not able to meet the power generation level they were committed to. Incidents which impact on the level of gas available occur regularly and encompass, for instance, delays in the unloading of LNG carrier, failures of technical equipment, etc.

406. It also happens, in particular during electricity or gas peak demand periods, that there is not enough gas available instantaneously to supply all customers. Further to the merger, the merged entity will have the incentive and the ability to give priority to EDP'S needs, in particular to TER, to the detriment of competing CCGTs which, as a

³⁰⁰ That is, the volume of gas they have to pay for irrespective of whether it is consumed.

³⁰¹ [...]

³⁰² [...]

³⁰³ [...]

result, will not be able to generate power at the level they have planned. In such situations, competitors will be unable to meet their commitments in power generation, whereas EDP will be in a position not only to gain new sales but to supply electricity at a higher price. Such behaviour is unlikely to be detected and sanctioned, as the topology of the gas network and the technical issues are complex enough for the merged entity to argue that it was not technically possible to supply its competitors with enough gas.

407. This was indeed confirmed by market participants, for example in the following terms: *“Further to the merger, EDP will also get control over gas infrastructures (LNG terminal, import pipeline, Carriço storage) and will thus have strong advantages: if there is a technical restriction in the gas system, EDP will be the only player to know it in advance and to adopt strategies so as to minimise the impact of the restriction on its power generation. EDP will also have the ability to go one step further and to discriminate between its needs in gas and those of its competitors. This is in particular possible in times of restrictions because of technical problems, delays in imports or high demand. It is very easy to find technical arguments to explain why some power plants were not given priority to be supplied with gas. On the contrary, the rest of the market players will have to build bid without knowing what EDP is up to and may suffer from certain practice. Complaints can be lodged but the process is long and it is not so easy to prove that a dominant player abused of its position in these markets. Besides there are numerous cross-shareholdings and the Portuguese market is very small: it is not obvious that a company actually lodges a complaint of this type.”*³⁰⁴ According to another gas supplier, the merged entity could also discriminate against the CCGTs of EDP’s competitors by invoking the “force majeure” clause to allocate the gas in a different way than agreed upon in the contract. This is not possible in present circumstances. It would be very difficult for competing CCGTs to prove that GDP had no ground to use this clause, or if they can do so, this would be only after a long time, which means much too late.
408. The fact that, under the current structure, EDP will keep a significant control of the gas entry points as well as the storage facilities could thus provide it with all the necessary means and incentives to make access to the gas network more difficult for its competitors, even though the high-pressure gas grid in Portugal is to be ownership-unbundled to REN.
409. In their replies to the Statement of Objections, the parties do not dispute that, further to the merger, EDP will enjoy significant advantages as to the management of the gas supply.

Conclusion

410. For these reasons, the Commission has come to the view that, thanks to its privileged and preferential access to natural gas resources available in Portugal, the concentration as notified will strengthen EDP’s dominant position in the wholesale electricity market in Portugal as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

³⁰⁴ Minutes of meeting with [...] on 27.8.2004

3. The merged entity will have the ability and the incentives to raise rivals' input costs

411. As a result of the merger the merged entity will, immediately or in the near future, have the ability and incentive to foreclose its competitors by raising the price of gas supplies or lowering the quality of supply.

The merged entity will have the ability and incentive to raise the price of Turbogás' short-term requirements

412. As an immediate result of the proposed operation, Turbogás will be supplied with gas by EDP, its main competitor on the electricity wholesale market. A significant part of Turbogás' gas requirements is covered by a long-term gas supply contract in which price formulae have been defined. Accordingly, it is unlikely that the merged entity would be able to raise prices as regards these requirements.
413. However, by contrast, Turbogás covers its short-term requirements (that is, additional needs for a short period) by concluding short-term contracts at arm's length. In this respect, ENI confirmed that "*at the buyer's request, subject to availability and agreement between the Parties regarding price and supply conditions, Transgás may also supply SEP's power plants on a short term basis.*"³⁰⁵ Since Turbogás will not be able to source these short-term requirements from independent suppliers for as long as the opening of the gas market is not effective in Portugal, the merged entity will thus have the ability and the incentive to raise a part of Turbogás' input costs. Further, as explained below (see paragraph 520),
414. Such conduct would be profitable to both EDP and ENI. In that regard,. Consequently, the fact of Turbogás' gas costs being increased would allow EDP to raise its prices to the detriment of consumers. ENI would have no reason to oppose such a pricing policy since increasing Turbogás' variable costs may not significantly alter the dispatching of Turbogás, that is to say, how often Turbogás actually runs and thus Turbogás' gas consumption. Besides, any reduced revenue due to a marginal loss of sales to Turbogás will be compensated in part by the higher gas price and in part by additional payments from EDP to GDP, for instance in the context of the supply contract with TER. Furthermore, for the reasons further explained below as regards future requirements of new CCGTs, such conduct would not necessarily (or at least obviously) constitute price discrimination if the technical and/or other external conditions determining the terms of Turbogás' short-term contracts were substantially different from those that determined the terms of EDP's contracts. This is all the more true inasmuch as important specificities and divergences exist as regards Turbogás' contracts³⁰⁶. In any event, it is likely, given the secrecy and the complexity of such specific clauses, that Turbogás or another public authority would not be in a position to detect such pricing strategy in due time.

³⁰⁵ ENI's reply to the Commission's Art. 11 request on 15.9.2004

³⁰⁶ See REN's reply the Commission's Art. 11 request on 1.9.2004. REN considers that [Turbogás] has the risk of entering TOP only if simultaneously a) Turbogás burns less than [...]bcm [billion cubic meters] and b) Transgás sells less than its own TOP (agreed upon with Sonatrach) worth [...]bcm. [On the contrary,] Transgás considers that Turbogás' TOP is [...]bcm irrespective of Transgás' sales over the years. However, so far, Turbogás has always consumed at least [...]bcm per year. This conflict may be reopened in the future when more efficient CCGTs enter into service and Turbogás is dispatched less often.

Future CCGTs, if any, are likely to be supplied by the merged entity

415. As was explained above, the Commission considers it unlikely that three new CCGTs, contrary to the parties' view, will be launched by competitors in the coming years (up to 2007/2008). However, even if such CCGTs were to become operational in this period, it is likely that at least some of these CCGTs would be supplied by GDP. One electricity player underlined in that regard that «*through the merger EDP would become the principal gas supplier to any potential competitors planning to enter the wholesale generation market in Portugal*»³⁰⁷
416. Indeed, it must be recalled that, pursuant to the Second Gas Directive, Portugal benefits from a derogation from the commencement calendar set out in that Community act, according to which it is only as from 2007 that the definition of eligible customers is to result in an opening of the market equal to at least 33% of the total annual gas consumption of the national gas market. All non-domestic customers are to become eligible at the latest in 2009, and all households at the latest in 2010³⁰⁸.
417. Notwithstanding this derogation, as already mentioned, the Portuguese Government approved two Resolutions³⁰⁹ in 2003 in order to anticipate the opening of the natural gas sector. These Resolutions provided that the electricity generators having a presence in Portugal would become eligible natural gas costumers from 1 July 2004 onwards. However, these resolutions have not been turned into law so far and the opening of this market has been delayed and is now expected to take place in the course of 2005³¹⁰.
418. Alongside these regulatory uncertainties, the Commission's investigation indicates that gas contracts for the purpose of operating a CCGT are generally negotiated 2 to 3 years in advance before the effective functioning of the plant because of technical (booking of capacities and of gas imports) as well as financial constraints (necessity of a viable business project for the purpose of bank financing).
419. In view of these elements, even if sufficient capacities were made available to other gas suppliers in the future, some power generators which would have planned to operate a CCGT in Portugal in the foreseeable future would likely choose to contract with GDP in order to secure effective gas supplies. In this respect, one power generator planning to possibly build and operate a new CCGT in Portugal confirmed that, indeed, it has exclusively negotiated with GDP for those reasons. Iberdrola, for its part, indicated that, in Portugal, it would attempt to supply a CCGT plant along with the supply of its other CCGTS in Spain only "*if the conditions allow it at the date at which it would become operational*"³¹¹.
420. It is all the more likely that new entrants, if any, would have to contract gas supplies with GDP if they are not in a position to source gas from an independent supplier because of the limited import capacity available for third parties. Indeed, it has been

³⁰⁷ Reply by [...] to the Commission's Art. 11 letter of 3.9.2004

³⁰⁸ See Articles 23(1) and 28(3) of the Second Gas Directive.

³⁰⁹ Resolutions of the Council of Ministers 63/2003 of 3 March 2003 and 68/2003 of 10 May 2003.

³¹⁰ During a meeting with the Commission on 24.9.2004, the Portuguese government informed the Commission that the draft decree-law providing for the opening of the gas market to power producers has been abandoned. The government now plans to propose a law which would provide for the opening of the various categories of customers, according to a given timetable. This law is expected to be laid before the parliament in the course of 2005.

³¹¹ Reply to question 9 of the Commission's Article 11 request dated 20.7.2004. [*"En Portugal se procederá así si las condiciones lo permiten a la fecha de puesta de entrada en servicio"*]

shown above that there is currently and in the future no capacity available³¹² in the international pipeline entering Portugal at Campo Maior. As regards the Sinès LNG terminal, GDP has already contracted [...] * Mcm of LNG out of the 5256 Mcm total capacity of the LNG terminal: the parties argue that [1500-1900] * Mcm are free. [...]*

421. Consequently, it is likely that, following the merger, the merged entity - and hence EDP – would supply gas to (most of) EDP’s competitors willing to be active on the wholesale electricity market in the near future.

EDP will have the ability and incentive to raise the gas costs of competing CCGTs

422. As a result of the operation, EDP, through the merged entity, will thus have the ability and the incentive to significantly influence the level of gas prices for those companies potentially involved in electricity generation through the operation of new CCGTs. Another electricity player confirmed that: “*Clearly this merger could give EDP+GDP the possibility of affecting the price of electricity in the wholesale market through the control of supply of gas natural to other generators, reducing competition in both electricity and gas markets.*”³¹³
423. Since EDP is not at all times dependent on natural gas as an input for its generation activity (because of the breadth of its installed capacity) and, more importantly, since it has, in any case, already contracted its new CCGT’s future needs, the merged entity will indeed be in a position, following the merger, to raise prices for all new requirements of natural gas. Having already contracted its new CCGT’s future long-term needs EDP would not harm its own interests as a power generator by this course of action.
424. Contrary to what the parties argue³¹⁴, such conduct will not necessarily constitute price discrimination within the meaning of Article 82 EC if the contractual provisions in the rival’s contract (volume of gas contracted under the TOP clause, duration of the contract, specific clauses), are substantially different from the ones that were included in EDP’s contracts or if other external conditions (date of signing of the contract, remaining available capacities, international gas procurement contracts, political stability in producer countries, and so on) are substantially different from the ones that existed at the time of EDP’s contracts.
425. In any event, even if such conduct were ultimately considered as an abuse of an existing dominant position, it is nonetheless likely that, in the present market context, the merged entity would have strong incentives to act in such a manner. Indeed, as was explained above, there is no transparency as regards the price formulae applicable in gas supply contracts since such information is crucial for the competitive operation of a CCGT. Moreover, such contracts are characterised by their great technical complexity which result in the insertion of specific clauses adapted to each customer’s specific needs. For those reasons, it is very unlikely that a company would be in a position, at any given time, to effectively compare the terms of its contract with those applicable in EDP’s contracts with GDP. This is especially true as regards a regulator or any public authority, since they are not likely to detect such differences in due time. Consequently, even if such conduct were to be regarded as being prohibited *per se*, EDP’s incentive to raise its rivals’ gas costs through a detrimental pricing policy would

³¹² As explained previously, the capacity available on average is not relevant to import gas: what matters is the capacity on which the importer can count on and book.

³¹³ Reply by [...] to the Commission’s Art. 11 letter on 20.7.2004

³¹⁴ Reply to the Commission’s Article 6.1.c decision.

be unlikely to be eliminated by the potential illegality of such a conduct, given that its detection by competitors or public authorities would remain highly unlikely³¹⁵.

426. It should also be noted that such price increase strategy would be profitable for ENI³¹⁶ since it would have a limited impact on the gas volumes ENI would sell to these competitors. Indeed, these competitors have, in any event, to address a very inelastic electricity demand: increased costs are likely to be passed on to the electricity wholesale market and, in turn, to the electricity end-customers.
427. Furthermore, such a situation, in which potential competitors are faced with the prospect of being supplied by their main competitor if they ultimately want to enter the market in due time, is also likely to further deter or delay entry of effective competitors in Portugal. This would not run counter to ENI's interest in selling higher quantities of gas, since EDP would be best placed to build and operate additional new CCGTs. [...]*. In addition, ENI has strong incentives to ensure that additional CCGTs are built by EDP in the future since, for its gas supply, EDP will turn to GDP, in which ENI holds a close to 50% share, and will – undoubtedly - not seek to promote the entry of a new gas company into Portugal.
428. It follows from these findings that, as a result of the operation, EDP will have the ability and the incentive to significantly foreclose its competitors involved in electricity generation through gas-fired power plants by raising the level of gas prices and/or lowering the quality of supply. This factor, in itself, will strengthen EDP's dominant position on the electricity wholesale market in Portugal, thereby significantly impeding effective competition in this market.

(c) Conclusion

429. For all the reasons mentioned above, considered either individually or together, the Commission has come to the view that the concentration as notified will strengthen EDP's dominant position in the wholesale electricity market in Portugal as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

2. Market for ancillary services

430. As explained in paragraph 187, irrespective of whether an Iberian market might appear in the foreseeable future, the market for ancillary services will remain national in scope. Only power producers located in Portugal will be authorised to participate in this market. For the time being, EDP is the only player in Portugal able to meet the demand in this market. The investigation has confirmed that EDP is clearly dominant in this market.
431. The present operation will remove a potential entrant on the electricity market, and therefore a potential provider of ancillary services. Based on all the reasons set out in the assessment of the wholesale market, and given that only a few plants can provide such services, GDP's entry on the wholesale market would have weakened EDP's position in the provision of ancillary services. The concentration results in the elimination of this potential competitor in the market for the provision of ancillary services.

³¹⁵ See Case T-5/02, Tetra Laval/Commission [2002] ECR II-4381, at paragraph 159.

³¹⁶ ENI will hold 49% of GDP further to the merger. ENI is a major player in gas sectors, at all levels of the gas chain.

432. For this reason, the Commission has come to the view that the concentration as notified would strengthen EDP's dominant position in the market for the provision of ancillary services in Portugal as a result of which effective competition would be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

3. Retail supply of electricity

(a) EDP holds a dominant position on the retail markets for electricity in Portugal

433. Many elements indicate that EDP clearly holds a dominant position on the Portuguese electricity retail markets, the market for supply of electricity to large industrial customers and the market for supply of electricity to LV customers. [...]³¹⁷

434. First of all, apart from EDP, the only two players active in the electricity retail markets in Portugal sold only 1324 GWh in 2003 while the total consumption on the market was of 38,915 GWh. Thus, EDP holds more than [90-100]*% of the retail market.

435. Essentially, the market that was eligible in 2003 was the market for supply of electricity to large industrial customers (45% of total consumption). With these eligible large industrial customers, competitors only had a market share of [0-10]*% in terms of consumption while EDP held the remaining [90-100]*%.

436. EDP's dominance is all the more entrenched as EDP is the only company to supply the regulated system, which accounts for 90% of the consumption in Portugal (and even more in numbers of customers). This situation will be perpetuated as the applicable Portuguese regulations provide that EDP will keep supplying the whole regulated system even after the termination of the PPAs as a regulated supplier.

437. In addition, EDP also holds the electricity distribution grid in Portugal (in particular, EDP owns all municipal concessions for distribution of electricity in low voltage). This grid confers EDP a strong advantage since it allows EDP to have a direct contact with the customers.

438. As a former monopolist EDP also has the information on the consumption profiles of all customers (even the historical information of those customers who have recently chosen an alternative supplier), which is crucial information when giving a quotation to a customer.

439. As a result, EDP has been able to retain the vast majority of the eligible large industrial customers who have switched from the regulated system (SEP) to the liberalised system. As of 2003, [70-80]*% of all customers who so far had switched from the SEP to the SENV have indeed remained with EDP, accounting for [60-70]*% of the total consumption in SENV in 2003³¹⁸. The figure of EDP's market segment share is significant as it is essentially the same as EDP's share of 2002 ([60-70]*% of switched large industrial customers' consumption in 2002), which means that competitors are not taking share from EDP in this segment. In 2003 the size of this segment was [20-30]*% of consumption of the large industrial customer market. This illustrates the incumbency advantage held by EDP on the Portuguese market, thanks to its de facto monopoly in the regulated system but also owing to its competitive advantages in the non-regulated area.

³¹⁷ [...]

³¹⁸ Appendix 11 to the Form CO. EDP even accounted for [70-80]*% of the electricity sold in the SENV, a share of which is acquired by EDPD for resale in SEP to bound customers.

440. It is also worth noting that the two other players in the retail markets have to import electricity from Spain. They thereby incur higher supply costs and risks, in particular because of numerous unpredictable congestions which force them to get power from players located in Portugal at a high price. So far, REN has supplied this shortage of power. In the future, it is likely that competitors will have to turn directly to power generators and will thus, probably be dependent on EDP.

441. [...] ³¹⁹

442. [...] ^{320 321}

443. In view of this evidence alone, EDP appears to hold a dominant position on the large industrial customer retail market in Portugal. This statement is especially true for the small customer market which only began to be opened in the course of 2004. Experience from other Member States shows clearly that the switching rates of those clients will be much lower than those of industrial customers. EDP's dominance will therefore only be challengeable at a slower pace.

The parties' position in their replies to the statement of objections

444. In their replies to the statement of objections, the parties do not dispute the Commission's conclusion that EDP holds a dominant position in the electricity retail market for small customers (LV).

445. As regards the electricity retail supply to large customers (HV and MV), the parties do not explicitly dispute the Commission's findings or the conclusion that EDP enjoys a dominant position in this market but bring forward arguments aiming to show that EDP's position is not so strong.

446. To this end, the parties focus only on the evolution of market shares in the free system, SENV. This approach is inconsistent with the fact that the relevant market encompasses all large customers irrespective of whether they are in the free or in the regulated system. This product market definition has not been disputed at all by the parties and reflects the competition between the conditions offered in the regulated system (in particular fixed and regulated tariffs) and those in the free system (free and possibly more fluctuating prices). The picture in the relevant market is quite different from that described by the parties, since the customers gained by competitors account only for a few percents of the overall market, dominated by EDP.

447. Even if only the free system is considered, the Commission disagrees with the parties' conclusions as to EDP's losses of customers and share. First, as is indicated in the table provided by EDP in its reply to the SO³²², EDP has not lost customers between 2003 and 2004. The increase of EDP's competitors' sales stems mainly from customers who switched from the regulated system. This switch accounts only for [0-5]*% of EDP's sales. Secondly, the parties "*stress that the Commission does not consider any extrapolation of past trends to assess EDP future position*"³²³ but refer only to the evolution between 2003 and 2004 to suggest a declining trend in EDP's market share. If a longer period is considered, the picture changes dramatically: between 2001 and

319 [...]

320 [...]

321 [...]

322 Table p. 44.

323 EDP's reply to the SO, 28.10.2004, p.42.

2004, EDP's market share has increased from [40-50]*³²⁴ up to [...] * while the size of the free system has been multiplied by 8. This shows that EDP has captured the vast majority of customers who switched to the free market (not to mention the vast majority who decided to remain with EDP in the regulated system).

448. In light of the above, the Commission has come to the conclusion that EDP holds a dominant position in the electricity retail supply markets to large customers (HV and MV) and small customers (LV).

(b) EDP's dominant positions will be strengthened as a result of the merger

449. The Commission's in-depth investigation confirms that the operation is likely to strengthen EDP's dominant position on the Portuguese retail electricity markets.

The merger will eliminate a significant potential competitor on both markets

450. The proposed operation will strengthen EDP's dominant positions since it will eliminate GDP as a significant potential competitor. During the Commission's investigation, respondents have indeed confirmed that GDP would be the most likely and effective potential entrant on these markets, in particular due to its customer base, its well-known national brand as well its ability to make dual-fuel offers.
451. As explained by one market player, "*Absent the merger, EDP and GDP would be best placed to enter the gas/electricity market. A good example of this is offered by the UK market. In Spain, Electricity and Gas incumbent players are the main source of competition. There is a crossover benefit if two different products can be sold to existing customers. There are similar risk profiles for both markets. Large customer bases, billing systems and metering systems can be used for both markets. And the two companies already have a client base, which partly overlaps. Moreover, the customer service costs can be lowered by offering both products together. As seen in the UK, gas suppliers would normally move to power generation. Customers tend to stick to their historic supplier. EDP or GDP, thanks to their strong brands and presence in Portugal could capture customers from each other. However, it seems very unlikely that non-Portuguese new entrants would manage to do so to a significant extent. [...] * Incumbents have strong advantages because they have the customer base, the info on it, the regular contacts with the customers. Even after liberalisation, distribution companies are usually in charge of fixing technical problems encountered by suppliers: they keep a direct contact with the customers of its competitors.*"³²⁵
452. In their reply to the Commission's 6(1)c decision, the parties argue that :

*"The current calendar for markets liberalization acts in itself as a legal prohibition of "dual fuel" offers and as an occasion for newcomers. In fact, electricity market full liberalization, as stated above, has been set by decree law to the 1st of July 2004, while the gas market liberalization is set to take off for consumers other than power generators on July 2007. By that time, current and potentially new players on the electricity retail market will be in a position to have strengthened their customer base and reinforced their brand awareness, thus matching what the Commission stated as a competitive advantage for GDP – its well-known national brand"*³²⁶

³²⁴ EDP's reply to the Commission's first questionnaire of 29.6.2004.

³²⁵ Agreed minutes of meeting with International Power, 14.9.2004.

³²⁶ The parties' reply to the Commission's 6(1)c decision, para 138

453. Firstly, it should be emphasized “dual offers” in themselves are not necessarily anti-competitive. Indeed, the concern is that GDP represents a more serious competitive constraint on EDP precisely because of its capability to introduce “dual offers”. Furthermore, the Commission is not aware of any regulation or law in Portugal which prevents GDP from launching a subsidiary active in the supply of electricity to retail customers. Given the strong brand associated with GDP and its knowledge of its customer base, this subsidiary could have developed effectively and exercised strong constraints on EDP. Even though this electricity subsidiary may have to be separate from GDP’s regulated gas activities, it would not be difficult to give customers the feeling that they are actually dual fuel customers of the same industrial group and could benefit from a bundled dual fuel offer at the earliest possible date.
454. Secondly, the gas markets in Portugal are due to start being liberalised as from 2007 at the latest. According to the Directive and Portugal’s derogation, the markets should be fully liberalised by 2010. However, the investigation of the Commission has revealed that local players expect gas liberalisation to take place at a much earlier date. [...]*, for instance, indicate that EDP expects the following calendar for gas liberalisation: [...]***³²⁷ These dates are far less remote than those mentioned by the parties.[...]***³²⁸
455. In view of the Spanish experience, CNE, the Spanish regulator, indeed confirmed that GDP would have been the most likely and effective potential entrant on the electricity markets [*“The Spanish experience confirmed that the gas and electricity incumbents are the best equipped potential competitors to enter each other’s markets”*], in particular because of their customer base [*“the gas incumbent have a customer base that can be used to develop the electricity business too, moreover they have important information regarding the customer and regular contact with him”*] and their brand [*“they have a well known brand which is an asset also to commercialise electricity: customers view the company as a company providing energy service, irrespective of whether it used to be only gas or only electricity”*]³²⁹.
456. A major gas supplier also explained that there were four main reasons for its own entry in its national electricity markets (while it was an incumbent in gas in the same area). *“First, it could rely on its gas customers to develop a new business, through dual fuel offers. Second, it wanted to gain electricity clients to compensate the foreseeable reduction of its market shares in the gas markets after the liberalisation of this sector. Third, it could use its CCGTs as “virtual gas storages” (if it had gas in excess, it could use it in the CCGTs). Fourth, if GN wanted to enter the retail electricity market, it had to operate as well in the generation and wholesale of electricity to hedge the risk of an increase of the price of electricity in the pool: if this price went up a lot, it would have lost money in the retail activity (where prices are constrained by the regulated tariffs), but would have gained more in the wholesale market”*³³⁰. It also underlined the importance of the brand in such a context [*“According to our experience in Spain, the brand of a supply company is very important to convince customers to switch from the regulated market to the free market and to improve the switch to another supplier”*³³¹].
457. The gas incumbent in the UK (Centrica) also confirmed the likelihood of GDP entering the retail markets in the absence of the merger, by underlining the ability of such a gas

³²⁷ [...]

³²⁸ [...]

³²⁹ Agreed minutes of meeting with CNE, 14.9.2004

³³⁰ Agreed minutes of meeting with Gas Natural of 27.8.2004.

³³¹ Gas Natural’ reply of 30.7.2004 to the Commission Article 11 request.

incumbent to rely on and further strengthen its existing customer base, for instance by developing dual-fuel offers: “Almost 80% of [Centrica’s] electricity customers are dual-fuel customers”³³².

458. The possibility to develop dual-fuel offers was also put forward as a important factor by other respondents when explaining why GDP should be considered as the best placed entrant in the retail market: “The main reason for GDP [to be the best placed to enter the electricity retail] in SME/residential segment is having a name recognition in Portugal, access to gas critical for dual offers in those segments.”³³³. Other factors such as the importance of having a local brand, a local network [“Our choice of GDP as the best placed in the Portuguese [electricity] market is based on the strength of its brand and its geographic extension due to its gas distribution network”³³⁴], as well as local sales force were also emphasised by competitors [“having important local sales force and a good knowledge of the Portuguese market”]³³⁵. On the long run, GDP could also have relied on the power produced by the CCGT it planned to build in Sinès, to obtain power at competitive prices without depending on third parties or unpredictable congestions, unlike EDP’s current electricity competitors.
459. The importance of these features has also been underlined by customers in Portugal. In reply to the Commission’s investigation, 39% of respondents ranked the local presence (sales force/technical support) as the most important criterion when choosing a electricity supplier. Then come as the second and third most important criteria, respectively, “existing relationships” and “a strong customer base in Portugal”. This investigation also shows that GDP is perceived by electricity customers as the most credible electricity supplier:
460. A clear majority of respondents on the demand-side confirmed³³⁶ that a gas player such as GDP is best placed to enter the electricity markets. GDP (or a subsidiary thereof) is ranked as the most credible electricity supplier by 35% of the respondents. In comparison, Iberdrola and Endesa have been ranked in first position only 25% and 20% of the time. Amongst the most important criteria for choosing an electricity supplier, electricity customers mentioned in first place the local presence (sales force/technical support) (39% of respondents) as well as pre-existing supplier-customer relationships and a strong customer base in Portugal.
461. As to whether there are important distinctions relating to GDP’s potential entry into the large customer retail market and into the LV customer retail market, the argument has been set out that large industrial customers would be less interested in dual fuel offers. It is correct that the experience from other Member States could point in that direction. However, the fact remains that many large industrial customers who responded to the Commission’s request for information declared that they are interested in dual fuel offers (50 %). Also, large industrial customers, when asked to rank the necessary track record of an electricity supplier, valued criteria like “company with whom we have already worked” and “multi-utility company” more highly than “established electricity supplier in Spain” or “big international electricity company”. Moreover, it should be recalled that 58% of the responding Portuguese large industrial customers declared that the natural gas operator is well placed to enter electricity wholesale and retail markets.

³³² E-mail by Centrica on 30.9.2004.

³³³ Enel Viesgo’s reply of 4.10.2004 to the Commission’s Art. 11 request.

³³⁴ Unión Fenosa’s reply of 4.10.2004 to the Commission’s Art. 11 request.

³³⁵ Enel Viesgo’s reply of 4.10.2004 to the Commission’s Art. 11 request.

³³⁶ Art. 11 request sent on 24.9.2004.

³³⁷ While it may therefore be true that dual fuel offers play an *even greater* role with LV customers, this does not mean that the offer is uninteresting for large industrial customers, combined of course with the expectation of a total-volume- based price reduction.

462. A similar statement can be made regarding the importance of the brand. It is widely assumed that the “energy brand” plays a larger role with small LV customers. However, if the meaning of the concept is shifted towards other reputational criteria such as “established, well-known reliable supplier” this distinction is no longer so obvious. “Local sales force and technical support” plays a leading role among the supplier criteria not only among the respondents that were supplied in LV electricity (representing the upper end of LV customers) but also among those that were supplied in MV and HV (namely, the large industrial customers), followed, at a distance, by “existing relations”. Among the responding LV customers and also among the responding HV and MV customers GALP/GDP enjoys a clear advantage over its competitors (mainly Iberdrola, Endesa) when asked for the most credible electricity supplier. As regards HV/MV customers this result is all the more significant as Endesa and Iberdrola are, as outlined above, already present on this market whereas GALP/GDP for the time being is still only a potential competitor.³³⁸
463. According to the Commission’s investigation, GDP was also perceived by EDP itself as the most likely potential competitor in the retail markets. When identifying the positive and negative aspects of the proposed operation, the risks represented by gas LDCs for EDP’s electricity activities were explicitly presented in the following terms:[...]*:³³⁹. This conclusion is drawn in particular from the UK: [...]*³⁴⁰, in which it is mentioned that a power incumbent in a given area has lost on average only 17% of its customer base, out of which the greater part (10% out of 17%) has been lost to the gas incumbent. Further, it is stated that the operation provides [...]*³⁴¹ In the same document, when considering the opportunities of the alliance for ENI, it is mentioned that the planned operation will [...]*³⁴²
464. All these elements therefore confirm that, in accordance with the experience observed in other Member States, GDP had strong incentives to enter both retail electricity markets, the market for supplies to large industrial customers and the market for electricity supplies for LV customers, prior to the merger and was likely to grow into an effective competitive force due to the various incumbency advantages that it could rely on as the major gas supplier in Portugal.
465. Furthermore, contrary to GDP other potential entrants face significant barriers to entry. Indeed, as was explained by an electricity player: « *To be successful, a retail supplier in Portugal will need to have the following: (i) access to wholesale power from generating assets in Portugal in order to manage commodity price risks; (ii) to have a critical mass of existing customer accounts in order to spread the fixed operating*

³³⁷ Commission’s first questionnaire to large customers, 14.7.2004. The other two criteria which ranked highly were “company operating the electricity grid”, adding to EDP’s incumbency advantage, and “company which has power production capacities in Portugal”, which as is shown above, is a real possibility for GDP.

³³⁸ Replies to Commission questionnaire to customers of 24.9.2004.

³³⁹ [...]

³⁴⁰ [...]

³⁴¹ [...]

³⁴² [...]

sufficiently to be competitive in the retail market; (iii) to have an economically viable customer base and local sales force.»³⁴³.

466. Moreover, subsequent to the acquisition of its main potential competitor in Portugal, EDP will remain the only company able to propose, within a relatively short period of time, dual-fuel offers of natural gas and electricity to Portuguese customers, whereas, absent the merger, both companies would have been in a position to do so for the benefit of consumers. Thus, to be successful, potential entrants on the retail market would have to consider the need to operate simultaneously in both the gas and the electricity retail markets
467. There may well be a specific customer group, particularly among LV customers, which prefers dual fuel offers for reasons of convenience (one service and metering contact, one bill). To reach these customers with an attractive offer, new entrants would need to match an offer by an entity which has the incumbents' advantages in both products. This would obviously be much more difficult than to just "beat" the dual fuel offer of two separate companies, each of which would hold only one incumbency strength, and from the start no or (as in the case of Portgás) only a small common customer base in both products, as could be expected to be the case without the merger. As explained by Centrica: "*the deeper the customer relationship (i.e. the more products a customer holds with a particular energy company), the less likely they are to switch.*"³⁴⁴ In this respect the merger would raise barriers to entry as it would signal the unassailability of the merged entity's position
468. Offering dual-fuel will thus allow the merged entity to retain customers more easily. In that respect, [...] ³⁴⁵.
469. It is very unlikely that any other player will be able to match EDP's dual fuel offers within a relatively short period of time. Indeed, even absent the merger this would be a difficult challenge for any other company. Iberdrola and Endesa would have to launch a gas business nearly from scratch: in Iberdrola's case from a very small position if the proposed sale of the two small LDCs goes ahead; Endesa has a certain minority shareholder position in Portgás but it is very unlikely that with the increase presence of EDP it can use this base to develop its own gas business in Portugal. Both companies would have to do it without being able to use the gas currently available in the Spanish gas network, since EDP would control the relevant transport rights in the pipeline which links Spain to Portugal. After the merger, as will be shown below, the chances of both companies would be reduced for entering into the supply of natural gas to CCGTs or to LDCs due to customer foreclosure and to large industrial customers and LV customers owing to the strengthened dominance of GDP. They would therefore find it even more difficult to make an attractive dual fuel offer to electricity retail customers in Portugal. Similar considerations would be true for Gas Natural which so far has no presence in Portugal.

The parties' position in their replies to the statement of objections

470. In their replies to the statement of objections, the parties do not dispute the findings of the Commission described above but only state that other players are also possible future alternatives to EDP. The parties do not comment on the fact that both

³⁴³ Reply by [...] to the Commission's Art. 11 letter on 3.9.2004

³⁴⁴ E-mail by Centrica on 30.9.2004.

³⁴⁵ [...].

competitors and customers have considered GDP as the best placed to compete with EDP in the electricity markets.

471. The parties do not contest either the importance of the brand or the fact that no regulation prevents GDP from selling electricity, despite its activities in the gas sector. As regards the question of whether customers favour dual-offers, the parties do not comment on the opinions expressed by competitors and customers (all pointing toward the strategic importance of dual-offer) and refer only to Gas Natural's answer to conclude that "competitors seem to share the parties' view."³⁴⁶
472. The parties insist that GDP would also have to enter the wholesale electricity market and that this would represent an additional barrier to entry. However, as described earlier in detail, the Commission has established that GDP [...]*, which is not contested by the parties, in particular by ENI, in the replies to the statement of objections.

Conclusion

473. In light of these elements, the Commission has come to the conclusion that the concentration as notified would strengthen EDP's dominant position in the retail electricity markets in Portugal as a result of which effective competition would be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

³⁴⁶ EDP's reply to the SO, p. 46.

B. Natural Gas markets

1. GDP holds a dominant position on the natural gas markets in Portugal

474. As was already mentioned, the Portuguese gas sector is characterised by the exclusive rights conferred by the national authorities to different companies of the GDP group for almost all the activities of the natural gas commercial chain in Portugal.
475. GDP, through its wholly owned subsidiary Transgás, has an exclusive right to the importation, re-gasification, storage and transportation (through the high pressure³⁴⁷ network or any other terrestrial or maritime way) of natural gas, as well as to its supply to distribution companies (LDCs) or direct clients (power producers and industrial customers, including co-generators, with an annual consumption over 2 Mm³).
476. Downstream, GDP controls, at the moment, five of the six existing LDCs (Lisboagás, Lusitaniagás, Setgás, Beirágas and Tagusgás), each of them having an exclusive right for the distribution of natural gas within their concession area, that is to say, for the transportation of natural gas in these areas through the medium and low pressure³⁴⁸ network and its sale to industrial and commercial clients with an annual consumption below 2 Mm³, and to households. The only local distribution company which at the moment is not controlled by GDP is Portgás (active in the area of Porto), over which, prior to the merger, EDP acquired joint control with an option on GDP's remaining share. Furthermore, through the controlled companies Dianagás, Duriensegás, Medigás, Paxgás, GDP has an exclusive right for the supply of natural gas in four autonomous areas not connected with the transmission network (UADs).
477. Through this position as legal monopolist in the pre-liberalisation period, GDP is currently dominant³⁴⁹ on all gas markets (in particular on the markets for supply of natural gas to CCGTs, to LDCs, to LICs, and to small customers), with the only exception of the market for the supply of gas to small customers in the area of Porto.
478. However, as was explained above, the liberalisation of small customers will lead to the creation of commercial supply companies stemming from the current LDCs and, potentially, to new entry, for the supply of customers who have switched to the open system. These new non-regulated commercial retailers – (at least) one stemming from the GDP-controlled LDCs and one stemming from Portgás – will very probably be active at the national level since a nationwide supply of what may be only a limited number of switchers can be performed in a much more cost-effective way than regional supply. In addition, the tariff system and supply conditions of the regulated market will be the same across the country. It is therefore highly likely that the market for the supply of gas to small customers will become national.³⁵⁰
479. In this market, the only customers that GDP will not hold are those of Portgás, which is controlled by EDP. GDP's customer base will therefore encompass [80-90]*% of the

³⁴⁷ Over 20 bars.

³⁴⁸ Respectively between 4 and 20 bars and below 4 bars.

³⁴⁹ In this respect, it can be recalled that “it is settled case-law that an undertaking having a statutory monopoly over a substantial part of the common market may be regarded as holding a dominant position” (Joined Cases C-147/97 and C-148/97 *Deutsche Post* [2000] ECR I-825, point 38).

³⁵⁰ Cf also Case *Verbund/Energie Allianz* where, in the small-customer electricity retail market, the Commission found that the activity of the new suppliers would progressively transform previously local markets into national markets (paras 96 and 126).

small gas customers in Portugal, accounting for [70-80]*% of the consumption of gas in this market. For the sake of completeness, it has also to be recalled that, in the context of the present operation, it is foreseen that two LDCs would be sold to Iberdrola. However, these LDCs account only for [0-10]*% of the overall consumption and cover rural areas of low commercial and industrial density in which developing the network is long and capital-intensive. As explained by Iberdrola³⁵¹, the LDCs are not such as to alter GDP's dominant position in the small customer market. On the basis of these findings, which are not contested by the parties in their replies to the statement of objections, it can therefore be concluded that, after the opening to competition of the supply of gas to small customers (currently LDCs customers), GDP will hold a dominant position on this market as well.

480. It should also be underlined that, contrary to the parties' view, GDP's dominant position is not likely to be significantly threatened in the short term by Spanish energy players, for the reasons set out below.

GDP's incumbency advantages

481. Leading from the beginning the project for the introduction and development of natural gas in Portugal and acting as a legal monopolist, GDP has acquired (and is still acquiring) significant incumbency advantages vis-à-vis potential new entrants. In particular, (i) it has gained a strong experience and knowledge of the Portuguese gas markets at every level, (ii) it has established a large customer base and a significant volume of sales in the country, (iii) it has developed very well known brands both at national and local level, and (iv) it has acquired a unique knowledge of the customers' profile (in terms of consumption, or solvency and credit terms) and specific needs (such as need for additional services or special customer care), (v) it controls, through the GDP-controlled LDCs, the distribution system operators.
482. In their replies to the statement of objections, the parties argue that such advantages are only apparent or, in any event, not such as to significantly affect the Spanish energy players' chances of effectively competing on the Portuguese relevant gas markets.
483. As for the point *sub (i)*, they argue in particular that gas markets work more or less the same all over the world and that, in any event, the possible need for additional knowledge of local market conditions might be easily met by hiring the appropriate staff from the local incumbent. However, it remains that the Portuguese incumbent (and ex-monopolist) has a unique knowledge of the specific features and of the concrete functioning of the national gas system. Moreover, the fact that, in order to get some specific and additional knowledge of local market conditions, newcomers might need to hire staff from the local incumbent clearly shows that the latter enjoys incumbency advantages vis-à-vis foreign competitors.
484. Concerning the point *sub (ii)*, the parties argue that a critical mass of customers is not needed by players like the ones based in Spain, on the ground that they already have in their portfolio volumes of gas necessary to supply the Portuguese market. However, the Commission's market investigation shows that a critical mass of sales is needed in order to enter the gas markets profitably. First, as was explained by a global gas player, in order to enter profitably the Portuguese gas markets, "*it would be necessary to have a minimum combined volume [of sales] that leads to a regular schedule of LNG cargoes, say one cargo per month to create viable supply chain economies*"³⁵². As is

³⁵¹ Agreed Minutes of meeting with Iberdrola, 8.9.2004

³⁵² See Shell's answer to question 40 of the Commission's questionnaire of 17.9.2004.

underlined by another important gas player, “*a critical mass within Portugal is important for the supply of gas to small residential and non-residential customers who require the development of local commercial and marketing organisations*”³⁵³. The need of a critical mass of sales has also been confirmed by important Spanish gas operators like Gas Natural and Endesa³⁵⁴.

485. Concerning the point *sub (iii)*, the parties argue that brands of global or Spanish gas operators are well known and that any residual possible advantages of GDP’s brands become less significant for wholesale customers. However, it remains that GDP’s well established national and local brands, and in particular its LDCs’ brands, give this company an additional advantage for the supply of gas to small customers.
486. In relation to the points *sub (iv and v)*, the parties observe that the Second Gas Directive requires the legal unbundling of the LDCs and its Article 14 establishes that information gathered by the unbundled LDCs shall be preserved as confidential, disclosed in a non-discriminatory manner and not abused in the context of sales or purchases of natural gas by related undertakings³⁵⁵.
487. In this respect, it should first be noted that Article 14 of the Second Gas Directive only refers to the information obtained in carrying out the business of distribution system operator and not to the information on customers’ profile and specific commercial needs (see point *iv*). This commercial information may (and will very likely) be retained by the supply companies stemming from the unbundling of the LDCs, which will supply the eligible customers in the free system. The competitive advantages coming from such information have not been contested by the parties.
488. Second, as far as the control of the distribution system operators is concerned, the Commission’s investigation shows that, irrespective of the provisions of the Second Gas Directive, the supply companies belonging to the same group of such operator have significant advantages *vis-à-vis* their competitors. In particular, CNE (the Spanish regulator who is responsible for enforcing the rules established by the Directive) stresses in that respect that: “*In addition to the fact that a distribution company has access to all crucial information about the customers (address, consumption, etc.), it also has regular contacts with the customers. This puts the distribution company in a better position at the moment in which the customer becomes free to choose its supplier to either stay with the distribution company within the regulated market or switch to the trading arm of its group, being one of the first to propose a discount off the tariff. In gas, the distribution company has contacts in particular through the technical inspections which are made for new installations (i.e. new clients) and then*

³⁵³ See Electrabel’s answer to question 40 of the Commission’s questionnaire of 17.9.2004.

³⁵⁴ In its answer to question 40 of the Commission’s questionnaire of 17.9.2004, Gas Natural acknowledged the existence of a critical mass of sales, but was unable to quantify it, because “*ello depende del margen de cada segmento de cliente y de los costes asociados a la flexibilidad y ajuste de desbalances*”. Also, Endesa in its answer to question 40 of the Commission’s questionnaire of 17.9.2004 indicated the minimum mass of sales needed to enter the different gas markets (assuming that access to the Campo Maior entry point was available) and specified that the “*volume required for the commercial and residential customers is due to the information systems requirements*”.

³⁵⁵ This Article states that: “1. Without prejudice to Article 16 or any other legal duty to disclose information, each distribution system operator shall preserve the confidentiality of commercially sensitive information obtained in the course of carrying out its business, and shall prevent information about its own activities which may be commercially advantageous from being disclosed in a discriminatory manner. 2. Distribution system operators shall not, in the context of sales or purchases of natural gas by related undertakings, abuse commercially sensitive information obtained from third parties in the context of providing or negotiating access to the system”.

regularly during the lifetime of the installation. (...) In gas, the first inspection is done by the distributor and the subsequent inspections can be done either by the distributor or by the new supplier. However, ensuring this service requires a lot of staff and is often sub-contracted to the incumbent distributor (which has the staff already). As a result, the distributor keeps the contacts with the customers. Other barriers can be the service and the costs for emergency services. The distributor and the new supplier have to negotiate the price of such sub-contracted services. This could be an additional barrier to entry for new suppliers and several new suppliers have complained that the incumbent charged very high prices for this negotiated services, thus raising the overall cost of gaining new customers”³⁵⁶.

The limited customer switching rate from the incumbent gas operator

489. As observed in other Member States where the opening of the markets has already taken place, there is a limited customer switching rate from the incumbent gas operator towards new entrants, in particular when, previously, these new entrants were not already well-established energy players in the area concerned. Information gathered by the Spanish regulator CNE shows that 96% of the gas incumbent’s customers who switched by December 2003 did so within the same group, that is, to the non-regulated supplier of the Gas Natural group. Total retention of switching customers was 91%, indicating that only 9% of those customers who switched could be motivated to switch to a group different from their previous LDC.³⁵⁷ This limited customer switching is particularly true for small customers.³⁵⁸
490. As for LICs, the possible switching would be limited and delayed by their existing contractual relations with Transgás, which - as explained by the parties - normally have a [...] year timeframe and are usually prolonged for an equal period of time. An average [...] year contractual period would mean that on average only 20% of customers would become contestable each year – a factor which necessarily strongly limits any possibility for quick erosion of the incumbent’s market power. LICs have also pointed out that they place a very high importance on security of supply and proven reliability of their energy suppliers. This is an additional factor which necessarily delays switching when LICs do not have a pre-existing relationship with the energy supplier.³⁵⁹

³⁵⁶ See agreed minutes of the meeting with CNE of 7.9.2004. In this respect it should also be underlined that the factor which by far ranked highest in Portuguese customers’ priority list in regard to their gas supplier was “*local sales force and technical support*” (see the responses to the Commission questionnaire to LIC and small gas customers of 22.9.2004).

³⁵⁷ Informe sobre el consumo de gas natural en 2003, p.47 (http://www.cne.es/pdf/PA008_04.pdf). The corresponding intra-group switching rates of the two regional incumbents Naturcorp and Endesa were lower but also with them their success rate with customers to whom they had previously supplied as a regulated supplier was significantly higher than their success rate with all customers.

³⁵⁸ This follows from the fact that above 90 % of the customers who switched, and are included in the above figures, were small customers (i.e. Spanish tariff group 3). Only a total of 5% of small customer demand had switched however. (http://www.cne.es/pdf/PA008_04.pdf) CNE data on the Spanish electricity markets also show that in the first half of 2004 small customers tended to switch to a supplier of the same group (i.e. switch from the regulated supplier to the non-regulated commercial supplier of the same group) to a very high extent (83-85% of all switches by volume). However, even large customers switched predominantly within the same group (75-77% of all switches by volume) (http://www.cne.es/pdf/IAP_evolelectricidad.pdf)

³⁵⁹ Phase I questionnaire to gas customers (LICs): Security of supply ranked even higher than price. A further indication that the incumbents have a good position also for retaining LICs is given by the fact that Gas Natural’s share in 2003 in the LIC area (Spanish tariff groups 2 and 3) in the open market was

491. In any event, considering GDP's very strong starting position, even if the fidelity rate of customers were lower than in other Member States (which does not seem probable), new entrants are not likely to challenge GDP's dominant position within the short term.
492. In their replies to the statement of objections, the parties do not contest the limited switching rate of the small customers from the incumbent gas operator. They argue, however, that the answers to the Commission's questionnaire show that a majority of LICs are ready to switch in exchange of a rebate of 5% or less of the present price. Furthermore, while acknowledging that a large majority of LICs indicated that they give priority to security of supply and reliability when choosing their energy suppliers, they nevertheless submit that there is no evidence that this always affects their willingness to turn to suppliers with which there has been no pre-existing relationship.
493. In this regard, the Commission is of the view that, although the LICs' preference for security and reliability will not necessarily *always* affect their willingness to change supplier, this is nevertheless an important factor that would certainly reduce their switching rate. In addition, a dominant player has the means to make entry very costly by reducing prices pre-emptively and temporarily only to those customers being targeted by new entrants, thereby significantly reducing switching rates.

Existing entry barriers

494. The power to threaten GDP's dominant position is also seriously reduced by the existence of several entry barriers, resulting in particular from (i) GDP's control over all the entry points in Portugal and over the only storage facility in the country, and (ii) the need for newcomers to achieve a critical size.
495. As for the first aspect, it is recalled that GDP/Transgás controls all the available entry capacity through the international pipeline coming from Algeria (at Campo Maior/Badajoz)³⁶⁰ and owns and operates the Sinès LNG terminal and the Carriço storage facility. For the reasons already stated above, GDP/Transgás can thus significantly limit access by third parties to the Portuguese network even if national regulations ultimately impose rules on third parties' access to the gas infrastructures.
496. Besides, the mere fact that the incumbent owns, and controls, all the entry points and the only storage facility in the country can by itself further deter or delay new entries, given that newcomers know that they would have to rely on their main competitor to have an access to the Portuguese market. As the experience of the Spanish market has shown, newcomers could indeed be concerned to obtain access to the gas

57%. Informe sobre el consumo de gas natural en el 2003, cuadro 4 (http://www.cne.es/pdf/PA008_04.pdf).

The Third Benchmarking Report on the Implementation of the Internal Electricity and Gas Market, Commission Draft Staff Working paper (1.3.2004) shows estimated switching rates of large eligible industrial customers in 10 EU Member States which range from 0% to 38% (average 13%) for the year 2002. The fact that the highest estimated value concerns Spain may suggest that intra-group switching is included. The average estimated switching rate without Spain is 10%.

³⁶⁰ In this context, the available entry capacity is considered as the total technical capacity of the pipeline minus the capacity which is allocated to Enagas for the supply of Galicia through the Portuguese territory. In this regard it should be underlined (i) that contractual provisions impede Enagas to deliver gas in Portugal and (ii) that it is not foreseeable that in the future, when an LNG terminal will be created in Galicia by the Reganosa group, Enagas will stop using this capacity to supply Galicia. As for the future plans of Enagas, in view of the fact that Enagas has to pay for the transmission of gas through Portugal, it is likely that gas will always transport gas through Portugal to Galicia even once the Reganosa LNG terminal starts operating. (See Agreed minutes of the meeting of 26.8.2004 with Enagas).

infrastructures at less favourable terms than the incumbent operator. In this respect, it is important to note that Gas Natural (the Spanish incumbent operator, which at the moment of the opening of gas markets also controlled, through Enagas, the main entry points) explained that, *“if EDP/GDP will control the Sinès LNG terminal, they could block the gas markets also without adopting illegal behaviour (especially at the beginning of the liberalisation process, before the adoption of specific rules for the different problems which could arise). After the liberalisation of the gas markets in Spain, things changed very quickly when Gas Natural left the control of Enagas. For instance, Enagas is now allowing and encouraging the sharing of the LNG ships among several gas operators in order to operate at best the terminals: this clearly favours the entry of gas operators which do not have many customers”*³⁶¹.

497. This concern of newcomers might be justified by the fact that the incumbent operator controlling the essential entry infrastructure would have many technical ways to favour its own imports without being detected and sanctioned by the competent authorities. In this respect, it should be noted that, in response to a Commission’s information request, the Portuguese regulator (ERSE) affirmed that, even if in future regulations as effective as possible are adopted, it *“cannot affirm that any discriminatory practice will be detected in time if there will not be ownership unbundling”* of the gas infrastructures³⁶².

498. Secondly, even if import infrastructures can be used efficiently by third parties, reaching a critical mass in terms of gas contract appears to be another significant barrier to entry. In order to be able to offer gas at competitive conditions, a supply contract for a significant volume (and usually considerable duration) has to be signed. As stated by Enagas: *“Under these conditions the most important asset for a new entrant is the supply contract.”*³⁶³ The majority of the energy companies which responded to the Commission’s information requests explained that it is not possible to find gas upstream at a competitive price without buying at least between 500 and 1000 Mm³/y³⁶⁴. A quantity of 500 to 2000 Mm³/y was estimated by some respondents to constitute the minimum critical size for entry.³⁶⁵ Furthermore, as already indicated, critical mass is also of crucial importance in terms of customer base. On the demand side, the new entrant has no certainty as to the pace it will be able to develop. This represents a high risk: if market conditions are quite uncertain and future developments can be hindered by a strong incumbent, some players may decide not to take this risk and hence not to enter the market. It would seem that such a risk is higher in a smaller, although significant, market such as in Portugal, given that new entrants would need an important market share to achieve such critical mass. The lowering of entry and procurement volume risk is one of the explanations why gas markets in other Member States such as the UK have developed rapidly after gas release programs were launched.

³⁶¹ See the agreed minutes of the meeting of 27.8.2004 between representatives of Gas Natural and some Commission’s officials.

³⁶² See ERSE’s response to question 25 of the Commission’s questionnaire of 28.7.2004.

³⁶³ Agreed Minutes of meeting with Enagas on 26.8.2004.

³⁶⁴ See in particular the answers of Gas Natural, Cepsa and Shell to the Commission’s questionnaires of 17.9.2004. Centrica’s reply to questions further to a meeting on 2.9.2004, dated 16.19.2004 (question 22).

³⁶⁵ See Cepsa’s and Shell’s replies to question 40 of the Commission’s questionnaire of 17.9.2004.

The level of growth of the Portuguese gas markets after the opening of competition

499. In their answer to the Commission's decision to open an in-depth investigation the parties stressed that the Portuguese market is still emergent and has an high growth rate which favours entries. In this respect it should, however, be underlined that, if the Portuguese market is growing quickly, this high level of growth is not expected to be maintained when the market opening process starts showing its main effects.

500. In response to a specific Commission's information request, ENI clarified in particular that:

*[...]*Conclusion*

501. Having regard to the foregoing considerations, it therefore appears that GDP holds a dominant position on all Portuguese gas markets (except on the market for sales of gas to small customers in the Porto area until the opening of that market to competition).

2. GDP's dominant position on the Portuguese gas markets will be strengthened as a result of the merger

502. Given the pre-existing dominant position of GDP on the different gas markets, the Commission has to assess whether this position will be strengthened by the notified concentration.

503. This analysis needs to be carried out in the framework of the forthcoming market opening of the gas sector in Portugal. In particular, the Commission has to consider that the supply of natural gas to power producers is expected to be opened soon (in the course of 2005) to competition, and that, pursuant to the Second Gas Directive, all non-household customers are to become eligible at the latest in 2009 and all households at the latest in 2010³⁶⁶. Even if not all the gas markets are currently being opened, the Commission stresses that the Directive does not leave any uncertainty as to the future opening of these markets and establishes clear and binding deadlines for the next steps in the liberalisation process, which are not subject to further prorogations (the Portuguese authorities can only anticipate, as they have announced on principle, the opening of these markets).

504. In this situation, the Commission will assess whether, owing to the notified concentration, GDP will be in a position to impede still further (or with greater facility) effective competition being introduced in the different gas markets and whether it will therefore have the power to behave still more independently of its competitors, its customers and ultimately of the consumers.

(a) Gas supply to power producers

505. The market of gas supply to power producers will be the first to be opened to competition in Portugal³⁶⁷. As it will be explained below, the possible entry of new gas operators risks to be prevented by the present concentration, given that it will very likely foreclose all the challengeable demand of the existing gas-fired power plants. Contrary to the parties' view, it is not possible to predict that this important

³⁶⁶ See Articles 2(31) and 28(3) of the Second Gas Directive.

³⁶⁷ As underlined above, this market was announced to be opened in 2004 and should now be opened in the course of 2005.

anticompetitive effect will be alleviated in the short or medium term by development of new demand following the construction of new CCGTs in the country.

Foreclosure of the existing demand

506. The use of natural gas for the electricity production (mainly in the CCGT power plants) has been the leading element for the introduction of natural gas in Portugal in 1997. As illustrated by the table above, the demand of power producers represents almost half of the total consumption of natural gas in Portugal. This percentage will rise subsequent to the full entry into operation of TER.
507. In this market, only two customers are currently present: Turbogás, which operates a CCGT in Tapada do Outeiro, and EDP, which operates a CCGT (TER) and a dual fuel plant in Carregado.
508. The average annual consumption of Turbogás amounts to around [...] Mm³³⁶⁸ of natural gas, while its maximal technical consumption is [...] Mm³ per year. This gas is provided by Transgás on the basis of a supply agreement signed in 1994 for a period of [...] years from the starting of the commercial operation of the CCGT's first unit (March 1999). [...]
509. EDP's CCGT, TER, is not fully operational yet. It is composed of three units, the first of which started operations in February 2004, the second in November 2004 while the third is expected to start in [...] 2006. Once fully operational, this plant will have a maximal technical consumption of [1500-1900] Mm³ per year. For its supply, in December 2003 EDP signed a contract with Transgás for a period of [...] years upon [...]. Under this contract, EDP has the right to purchase [...] Mm³ of natural gas per year for every unit, of which [...] subject to a take-or-pay obligation. Also in this case, the price results from the sum of a fix term (which should be paid anyway for the whole ACQ) and a variable term.
510. The current consumption of EDP's dual fuel plant amounts to around [100-150] Mm³ per year. This plant is in the SEP like Turbogás and is also operated on the basis of a triangular relationship with Transgás and REN.
511. Considering the long term supply contracts already in place for the three existing power plants and their take-or-pay obligations, after completion of the opening of the market, the scope for competition in this market will be limited. From a demand point of view, competition will indeed only take place for the short-term gas requirements of the three plants, which can theoretically go from the TOP quantity (usually significantly lower than the ACQ) to the maximal technical consumption (even if, partly on account of technical maintenance reasons, it appears unlikely that the effective consumption actually will reach the level of the maximal technical consumption). The obligation to pay anyway the fixed term for the whole ACQ might be an incentive to buy the whole ACQ from Transgás, unless other suppliers can offer gas at a price lower than the variable term.
512. The parties agree that, after the opening of the market, gas operators might compete for the supply of the short-term requirements of these three power plants. In their notification they clearly stated that *“any new entrant on the segment for the supply of natural gas to power producers in Portugal will be able to freely compete with GDP for the satisfaction of the short-term natural gas requirements of the existing CCGTs*

³⁶⁸ Average consumption for Power Production in SEP 1999-2003: [...]Mm³. Of this, around [...] Mm³ were consumed by EDP's dual fuel plant.

*and of EDP's Carregado dual fuel plant. In this regard, short term requirements refer to the difference between the TOP quantity and the effective yearly consumption. [...]**³⁶⁹.

513. Furthermore, in their answer to the Commission's decision to open an in-depth investigation the parties stressed that the short term requirements of the three gas-fired power plants should not be underestimated. In dry years, when only a reduced amount of hydro power is available, these plants may operate full-time and therefore reach the maximal technical consumption. In answer to a Commission's information request they underlined in particular that in [...]*
514. However, competition for the supply of these short term requirements is likely be prevented - or at least greatly reduced - by the customer foreclosure caused by the notified concentration. Indeed, after the concentration, the companies controlling the three gas-fired power plants are likely to lose the economic incentives or the legal opportunity to buy gas from new suppliers, for the following reasons.
515. First, as far as EDP is concerned, following the acquisition of joint control over GDP, it will have a strong incentive to purchase from GDP/Transgás the natural gas needed for short-term requirements of its two power plants, so as to increase its profits on the upstream market and to prevent entry from GDP's competitors.
516. Contrary to the parties' view, the fact that GDP's profits in the market for gas supply to power producers will be shared between EDP and ENI does not seem to overcome EDP's incentive to source gas from its co-controlled company. It is indeed clear that, all conditions being equal, EDP has an incentive to buy gas from GDP in order to increase its 51% participation in GDP's profits. This incentive might only disappear in the unlikely event that an independent gas supplier were to offer gas at a price significantly lower than the one of GDP, so that EDP's savings would exceed its possible increased participation in GDP's profits.
517. [...]*
518. [...]*
519. [...]*
520. *As concerns Turbogás' position*, it should be recalled that EDP has a 20% participation in this company and can therefore block all the decisions for which the vote of the Board of Directors representing at least 80% of the share capital is required. [...]*. If that is so, it is self-evident that after the notified concentration EDP will have every interest to exert its minority rights to veto any supply contract with gas operators other than GDP/Transgás. This view has been confirmed by the new main shareholder of Turbogás, International Power, which recently acquired 75% of Turbogás:

"Although Turbogás is supplied gas under a long-term contract, if at some point CCGTs are free to source gas from other companies than Transgás, Turbogás could source its short-term requirements from other companies. [...]. However, it seems difficult to make such a decision without EDP's consent. IP expects that this type of decision would require an 85% approval."*³⁷¹

³⁶⁹ Form CO, p. 125.

³⁷⁰ See ENI's answers to question 22 to the Commission's questionnaire of 19.8.2004.

³⁷¹ Agreed Minutes of meeting with International Power on 14.9.2004.

521. In the light of the above, it therefore appears that the notified concentration is likely to foreclose all the challengeable gas demand of power producers and therefore strengthen GDP's dominant position on the market in question.
522. In their replies to the statement of objections, the parties acknowledge the foreclosure of Turbogás' short term requirements, but contest the foreclosure of TER's gas demand and of EDP dual fuel plant's short term requirements. In this respect, they argue that the Commission did not consider that, after the concentration, EDP would buy gas from the operator offering the best price in order to reduce its production costs and be able to sell electricity at a competitive price.
523. However, such a scenario remains very unlikely. Indeed, the parties' argument ignores the fact that, after the concentration, Turbogás will also have to buy its short term requirements of gas from GDP. In that respect, it must be recalled that Turbogás is the only competitor, other than EDP, which can currently produce electricity in a gas-fired power plant in Portugal, and that it uses a similar but less efficient technology than TER. As a result, Turbogás is situated right next to TER (and indeed between TER and EDP's gas-fired dual fuel power plant in Carregado) in the electricity merit order, thereby exercising the strongest potential constraint on EDP's use of its gas-fired power plants. It follows that, by acquiring gas from GDP, EDP would increase its profits upstream without, in any event, losing competitiveness in the wholesale electricity market.

The creation of new demand

524. As mentioned above, the parties claim that the anticompetitive effect of customer foreclosure will be alleviated in the short to medium term by the development of new gas demand for power producers following the construction of new CCGTs in Portugal. In this respect, they observe in particular that three projects for new CCGTs were already envisaged prior to the merger: a first of Tejo Energia in Pego, a second of Iberdrola in Figueira da Foz and a third of Gas Natural in Sinès. The parties also argue that the Commission has overlooked the possibility that power generators might decide to convert existing oil-fired generation plants into dual-fuel plants or to replace them with new CCGTs plants.
525. However, as was already explained, the realisation of the three new alleged CCGTs remains very doubtful and, anyway, there are substantial uncertainties as to the timing of their possible start of operations. In addition, official bodies such as the system operators (REN and REE) and the Portuguese Directorate General for Geology and Energy (DGGE) have made studies according to which they do not forecast that any new CCGT apart from TER's three units will be needed to meet the demand³⁷². Hence, it is likely that no new CCGTs will be built in the foreseeable future, or at least that their construction will be delayed until after 2010.
526. Furthermore, it should also be considered that EDP might take action to delay these projects in many ways[...] or by trying to anticipate on its competitors' moves by speeding up a new project for the construction of its second CCGT³⁷³. If this were the case, the customer foreclosure effect of the present concentration would then be further extended to EDP's new CCGT.

³⁷² REN/REE: "Prevision conjunta de la cobertura", December 2003.

³⁷³ [...]

527. Finally, as for the possible conversion of existing oil-fired generation plants into dual-fuel plants or their possible replacement by new CCGTs, the Commission notes that the only power producer which owns oil-fired generation plants in Portugal is EDP. If this company were to transform its oil-fired plants into dual-fuel plants or replace them with new CCGTs, the customer foreclosure problem, as just mentioned, would be aggravated instead of being alleviated.

Conclusion

528. Having regard to the foregoing considerations, the Commission has come to the view that the concentration as notified will strengthen GDP's dominant position in the market for the supply of natural gas to power producers in Portugal, as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

(b) Gas supply to LDCs

529. As indicated in the paragraphs on market definition, when the supply of gas to LDCs will be liberalised, this will likely constitute a separate product market. In this market the demand will be represented by the six existing LDCs and/or the supply companies stemming from the unbundling of these LDCs (and potential non-integrated new entrants).

530. Even if these LDCs currently have long-term supply contracts with Transgás, the parties underlined that, "by the time the LDCs' and large industrial customers' segments will be liberalised, (...) contracts entered into by GDP/Transgás and the LDCs (...) could come to an end – according to clause 13 thereof – due to either party's concession expiry or, at least, be deeply reviewed in view of the new regulatory framework, with consequences on the existing long-term natural gas supply obligations between the LDCs and GDP/Transgás and the former companies' ability to shift their sourcing to alternative suppliers"³⁷⁴.

531. Considering that five of the six existing LDCs are controlled by GDP, it appears clear that, absent the notified concentration, of all LDCs, independent gas operators could have tried to supply gas only to Portgás, which is the only LDC not controlled by the incumbent gas operator. Even if GDP is an important minority shareholder in this company, absent the concentration, EDP could have exercised its pre-emption rights hindering any blocking position which GDP may or may not have had.

532. This challengeable gas demand will be foreclosed by the present concentration, considering that - in line with what it has been explained above - EDP after the merger will be strongly interested in inducing Portgás to continue purchasing gas from GDP/Transgás. In addition, it can be mentioned that the logical deduction that after the concentration Portgás will remain a customer of GDP/Transgás [...] ³⁷⁵

533. The gas demand of potential entrants seeking to supply gas to small customers will depend on their sales to their downstream customers. However, it is clear that these sales, if any, can be expected to be very small for a considerable period of time (for reasons of low switching rates with small customers) and will not allow any supplier to achieve critical mass in natural gas supplies to LDCs (and new retail suppliers) in Portugal, nor even to contribute significantly to achieving critical mass by supplying

³⁷⁴ See the parties' answer to the Commission's decision to open an in-depth investigation, paragraph 183.

³⁷⁵ [...]

Portuguese customers in other markets. Consequently, the most likely supplier to such a company would also be GDP.

534. The same is true for Iberdrola's LDCs and the supplier(s) stemming from them (if the operation to sell them to Iberdrola goes ahead). As mentioned above, Iberdrola views these LDCs as lacking in critical size as their joint demand in 2003 is merely [0-10]*% of all LDCs' demand. The parties have suggested that this demand is set to grow considerably, but forecast demand of these LDCs for 2007 is still very small ([0-10]*% of all LDCs' demand or [...] Mm³; compared with Portgás' [20-30]*% of LDCs' demand, or [...] Mm³).
535. It should be recalled that the minimum volume of gas needed to negotiate a viable contract upstream has been estimated at 500 – 1000 Mm³, which a supplier of Portgás could achieve through acquisition of a number of industrial customers, such as cogenerators, but which seems out of reach for a hypothetical supplier of Iberdrola's LDCs and potential non-integrated entrants into the supply of small customers.
536. In their replies to the statement of objections, the parties do not contest the foreclosure of Portgás' demand which, absent the concentration, would have been challengeable by other gas suppliers. However, they argue (i) that the size of Iberdrola's LDCs might grow even more than the [0-10]*% foreseen for 2007, (ii) that the required critical mass could be achieved by adding to the consumption of Iberdrola's LDCs, and of new retail suppliers, the consumption of other categories of customers, such as LICs and new CCGTs, and (iii) that the required minimum critical mass might hinder entry only for operators that would have to conclude new gas supply contracts in order to supply the Portuguese markets and not for companies like Iberdrola and Gas Natural, which might well decide to enter the Portuguese market using natural gas sourced under pre-existing contracts.
537. However, it remains that the concentration will have the effect of foreclosing a large majority of the gas demand that gas players could have challenged. As indicated, after the opening of competition in this market, the challengeable demand would be immediately represented by the consumption of Portgás ([...]* Mm³/y) and of Iberdrola's LDCs ([...]* Mm³/y). The foreclosure of Portgás' demand will therefore represent around [80-90]*% of the challengeable demand. It is therefore clear that, even in the unlikely case that, after a certain time, the consumption of Iberdrola's LDCs would grow considerably and new gas retailers would enter the market, the customer foreclosure caused by the concentration would remain very significant.
538. Consequently, the Commission is of the view that the concentration as notified will strengthen GDP's dominant position in the market for the supply of natural gas to LDCs in Portugal as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

(c) Gas supply to large industrial customers

539. As illustrated by the table above, the demand of LICs with an annual consumption above 2 Mm³ currently represents around half of the total gas demand in Portugal (a percentage which will decrease subsequent to the entry into operation of TER).
540. Pursuant to the Second Gas Directive, these customers, which are currently supplied by Transgás, will become eligible at the latest in 2009 (and may even be anticipated to 2006 according to the Portuguese government's declarations).

541. Taking into account the important business opportunities offered by these large gas customers, it is very likely that, absent the concentration, EDP would have become a significant competitor of GDP.
542. Indeed, EDP is an important (and will soon be the major) gas customer in Portugal for the requirements of its CCGT and its dual fuel power plant. Therefore, EDP would have a strong incentive to purchase gas on a larger scale and resell the part which exceeds its needs. In addition, operating a CCGT gives an important flexibility to the gas operators, who, according to the respective prices of gas and electricity, can decide to burn their gas for the production of energy or to sell it. In this respect, a gas player explains that:
- "EDP is the best-placed company to enter the gas markets in Portugal. If you are in control of a CCGT, you can easily divert the remaining gas to gas customers. Such diversion makes high economic sense. In addition to spreading your risks over several markets, it allows you to gain economies of scale (pooling of capacities for instance) and to have arbitrage between selling the gas or burning it depending on the respective prices. It provides higher flexibility both as a gas and an electricity supplier."*³⁷⁶
543. To proceed from such a position as a very large customer to a market player that sells gas itself is perceived as a logical step by many market participants, even by ENI which assumes, in discussing the future wholesale demand for natural gas in Portugal that this category of resellers to final users "includes also those power producers which decide to sell quantities of natural gas exceeding their own requirements."³⁷⁷ Referring to this inherent connection between gas retailing and operating CCGTs, Gas Natural termed CCGTs "virtual gas storages".³⁷⁸ The opinion was also expressed that companies operating CCGTs have a strong motivation to go into other gas markets because having the gas supply just for a CCGT is too risky.³⁷⁹
544. In addition, considering that - as it will be explained below - EDP is by far the most likely potential entrant in the retail market for the supply of gas to small customers, it would have had strong incentives to also enter the market for the supply of LICs in order to achieve economies of scale and scope.
545. Furthermore, absent the merger, EDP's entry into the market would have allowed it to make dual fuel offers in order to gain big industries both as gas and electricity customers. Even if these offers might be less attractive for large industrials than for smaller retail customers, the Commission's market investigation showed that these large customers may also be interested in dual fuel offers in order to get a better price for the two energy products. Therefore a strategy by EDP to make such dual fuel plus volume discount offers to its LIC customers would have a fairly good chance of success.
546. Finally, when asked in the Commission's market investigation to rank companies, and groups of companies, which they would expect to be their preferred alternative to GDP

³⁷⁶ Agreed Minutes of meeting with [...] on [...] in August 2004.

³⁷⁷ Eni's reply to question 10 of the Commission's request for information of 26 July 2004.

³⁷⁸ Gas Natural, however, in line with its own historic situation, interprets the connection in the other direction (step from gas retailing to CCGTs). It sees CCGTs as "virtual gas storages" (if a retailer has gas in excess, it can use it in the CCGTs). (Agreed minutes)

³⁷⁹ Agreed Minutes of the meeting with Enagas. On reselling gas by CCGT operators, see also Agreed Minutes of the meeting with BP.

suppliers of natural gas, the responding LICs mentioned two companies ahead of all others: Gas Natural and EDP. Big oil companies were ranked lower. Still further behind were Endesa and Iberdrola.

547. Having regard to these elements, the Commission considers that, without the merger, EDP would have been one of the most credible potential entrants if not the most credible potential entrant in the market for supplies to LICs. The operation would thus lead to the elimination of a main potential competitor and thereby strengthen GDP's dominant position on the market for the supply of natural gas to large industrial customers in Portugal.
548. In their replies to the statement of objections, the parties argue that the Commission underestimates the likelihood of Gas Natural's entry into the market for the supply of LICs and that other companies operating a CCGT in Portugal (International Power) or planning to build one (Iberdrola and Tejo Energia) might be well situated to enter.
549. The Commission does not underestimate the likelihood of other possible entries in this market, but considers nevertheless that EDP would be one of GDP's most credible potential competitors absent the merger. Taking into account GDP's strong dominant position, the elimination of such a significant potential competitor is likely to substantially increase the market power that this company would otherwise have.
550. On the basis of the foregoing considerations, the Commission has come to the view that the concentration as notified will strengthen GDP's dominant position in the market for the supply of natural gas to LICs in Portugal as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

(d) Alternative market definition: large wholesale market (gas supply to power producers, LDCs and large industrial customers)

551. As mentioned above, in their answer to the Commission's decision to open an in-depth investigation the parties claim that the Commission should assess the impact of the merger on a wider wholesale gas market comprising the supply of gas to power producers, LDCs and LICs.
552. The Commission does not agree with this proposed market definition. In any event, given the different time-frame for the opening of the gas markets, a specific assessment of the impact of the present concentration on the market for gas supply to power producers is needed.
553. Nevertheless, for the purpose of completeness, the Commission also analysed the likely effect of the notified concentration on the wider wholesale gas market suggested by the parties. In particular, the Commission assessed the impact on this wider market of the customer foreclosure effect caused by the concentration. For this purpose, the Commission first considered that, absent the concentration, independent operators could have challenged and then evaluated which part of this challengeable demand would probably be foreclosed by the notified concentration.
554. In particular, the Commission considered that the overall challengeable demand in this alleged larger market would have been composed (i) by the short term requirements of Turbogás and TER, (ii) by the consumption of Portgás (the only LDC not controlled by GDP) and (iii) by the consumption of large industrial clients excluding the cogeneration companies controlled (or jointly controlled) by GDP. The Commission has made this calculation for the year 2007.

555. The short term requirements of Turbogás, EDP's dual fuel plant and TER have been counted as suggested by the parties³⁸⁰. As shown above, no other CCGTs will be in operation. The demand of LDCs and in particular of Portgás has been counted as suggested by the parties. Iberdrola's potential LDC's have been counted as challengeable demand. LIC consumption has been assumed as stated in a paper by the parties supplied to the Commission at several meetings³⁸¹, and challengeable demand of LICs has been calculated accordingly³⁸². A cogenerator controlled by EDP was included in the challengeable demand. The foreclosed market volume was calculated as the sum of TER additional quantities, Turbogás' and EDP's dual fuel plant's additional quantities and EDP's cogenerator. This volume was calculated as a percentage of the volume of the challengeable demand in 2007.
556. In so doing, the Commission found that [60-70]*% of the challengeable demand will be foreclosed³⁸³. It must in addition be considered that challengeable demand by LICs was put in the calculation at an assumption unrealistically favourable for the parties, namely in the sense that these LICs would from now till effective market opening not conclude any more contracts with GDP and would all be challengeable in 2007. If this factor were taken into account and if it were further considered that the merging parties might succeed in securing just 50% of all challengeable demand in 2007, then no potential entrant could in that achieve critical mass as defined above.
557. These evaluations are not contested by the parties in their replies to the statement of objections.
558. It can therefore be concluded that, even in this (alleged) alternative wholesale market, the concentration as notified would strengthen GDP's dominant position as a result of which effective competition would be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

(e) Gas supply to small customers (small industrial, commercial and household customers)

559. As indicated above, pursuant to the Second Gas Directive all non-household customers will become eligible in Portugal at the latest in 2009 and all households at the latest in 2010. However, it has been announced by the Portuguese government that liberalisation in the sector of gas would be anticipated. In particular, the government announced that it would decide in June 2005 about the timing of the next steps of liberalisation. There are reports that the topic was also addressed during the recent summit between the Portuguese and Spanish Prime Ministers in Santiago de Compostela. A date for the full liberalisation of the Portuguese gas market in 2008 has been reported but has not been confirmed³⁸⁴. [...]*³⁸⁵

³⁸⁰ ENI's reply to the Commission's request for information, 30 August 2004, question 22. 3 units of TER were assumed in operation.

³⁸¹ Such as the meeting of 1.10.2004.

³⁸² LIC challengeable demand was calculated as annual estimated consumption minus customers whose current contract with GDP will still be ongoing minus consumption of two "captive" cogenerators with GDP participation (whose contracts were assumed to have ended).

³⁸³ Eliminating the uncertainties of all cogenerators' contracts and assuming all of them to be part of the ongoing Transgás contracts in 2007, the Commission arrived at a slightly lower but still very high figure of [50-60]% of foreclosed challengeable demand of all large customers combined.

³⁸⁴ A more cautious report is from Reuters: "*Fuentes diplomáticas dijeron a Reuters que, durante el encuentro, España pidió a Portugal avanzar también hacia un mercado común del gas natural, aunque*

560. Given that, pursuant to the Second Gas Directive, the market for the supply of gas will be opened to competition in Portugal, the question arises whether the concentration has the effect of strengthening GDP's dominant position by eliminating EDP as a significant potential competitor and thereby preventing the effective opening of the market to competition.
561. Several elements gathered by the Commission during the in-depth investigation show that, absent the merger, EDP would have been the main potential competitor on the market for the supply of gas to small customers.

As an electricity incumbent, EDP has strong advantages in entering the market for the supply of gas to small customers; the ownership of an LDC gives it further advantages and proves its ability to enter/expand

562. As is shown by experience in other Member States, incumbent electricity operators are very well placed to enter the gas retail markets successfully. In particular, in the UK and Italy, the electricity incumbents Powergen and ENEL have successfully entered the gas markets and become the main competitors of the incumbent gas operator (respectively, British Gas and ENI). Also many British regional electricity incumbents have entered the gas-supply market. Considering its contiguity and its connections with the Portuguese market, a pertinent example is also offered by the Spanish market, where all the big electricity operators (Endesa, Iberdrola, Hidrocarbónico and Unión Fenosa) have vigorously expanded their gas activities, either through successful entry (Iberdrola) or through strong expansion, partly through acquisitions, from the basis of previously quite small LDCs (Endesa, Hidrocarbónico and Unión Fenosa), all challenging the incumbent gas operator. The Spanish regulator explained the successful entry and expansion of the electricity operators in the gas markets in Spain in the following terms:

“The Spanish experience confirmed that the gas and electricity incumbents are the best equipped potential competitors to enter each other's markets.

(...) Today, the electricity companies (Endesa, Hidrocarbónico, Iberdrola and Union Fenosa) have become the fiercest competitors for the incumbent, due to the following advantages: 1) the fact that electricians need gas for the CCGTs that they had started to use more and more for electricity production. Having entered the gas market as buyers of big gas volumes, they could easily decide to enter the retail market as suppliers. In addition, they are now able to make arbitrage between using the gas to produce electricity and selling the gas to end-customers, depending on the price of gas as compared with that of electricity. This provides them a significant advantage vis-à-

no se negociaron potenciales fechas para su concreción debido a que Lisboa aún trabaja en un calendario para liberalizar ese sector.”

(http://www.reuters.com/locales/c_newsArticle.jsp?type=businessNews&localeKey=es_ES&storyID=6392937; 1.10.2004).

*An article published in *Publico* went further: “The Santiago summit was also marked by the announcement by Minister [for economic affairs and labour] Antonio Barreto to his Spanish counterpart, Jose Montilla [minister for industry, tourism and trade], of the timetable for the liberalization of the Portuguese gas sector. The revised timetable has brought plans forward by six months. As a result, as soon as 2005, gas will begin to be sold to combined-cycle power plants, followed by industrial customers a year later. The liberalized gas services will only reach the consumer in 2008. The two nations also vowed to harmonize national legislation on gas services and to move forward in the direction of market unification.” (<http://worldnews.xignite.com/xWorldNews.aspx?articleid=EUP20041002000069>;*

Originally published on 10/2/2004 by Publico (Internet Version-WWW) in Portuguese

*vis players who would be active in only one market by an increased flexibility vis-à-vis their TOP obligations and an optimisation of profits; 2) they have a customer base that can be used to develop the gas business too; 3) they have a well-known brand*³⁸⁶.

563. As outlined below, these factors were also highlighted by energy players during the in-depth investigation.
564. EDP's advantages can be grouped in three main bundles of advantages: (a) advantages in procurement due to EDP's position as a gas-fired power producer in Portugal; (b) advantages due to EDP's position as the incumbent electricity retailer and distributor (c) advantages due to its position in, and information on, gas retailing in Portugal (Portgás and information-sharing on Lisboagás).

Advantages in procurement due to CCGTs

565. Firstly, EDP is the major gas customer in Portugal for the requirements of its CCGT and dual fuel power plant, which gives a strong incentive to purchase gas on a larger scale and resell one part of its needs on the retail market in order to optimise its profits and possible economies of scale.
566. The gas consumption of CCGTs is quite erratic. Nevertheless, a fixed capacity has to be booked in terminals and pipes, and paid for. As a result, it makes high economic sense to start gas retail activities using the same gas contracts: gas can easily be diverted to customers with little additional cost. Also, by pooling the capacities, significant economies of scale can be achieved which are further incentives to enter gas retailing.
567. Iberdrola which successfully entered the gas markets in Spain confirms this view: "Crucial elements for developing the dual-fuel strategy are the following: (i) use of economies of scale thanks to the high consumption of Iberdrola's CCGTs, in particular as regards negotiating gas contracts and pooling transport of gas in the network (ii) optimise management of gas and electricity: opportunities of arbitrage between selling gas or burning it for power, depending on the respective prices, (iii) semi-integration upward: buy from the gas producer"³⁸⁷.
568. Moreover, EDF states that "operating a CCGT facilitates entry on gas retail markets. (...) This will not only translate into clear price reduction advantages but will also allow for price hedging possibilities due to pooling mechanisms (...) as well as balancing and price arbitrages"³⁸⁸

Advantages as an incumbent electricity retail distributor and supplier

569. Secondly, it appears that EDP, as the electricity retail incumbent in Portugal, would have had strong advantages in entering the Portuguese gas retail market for small customers, and incentives to do so. These advantages are due to three main reasons:

Customer contacts and relationships

570. EDP has the ability to rely on its unmatched customer base in the electricity market to enter the gas retail business. Indeed, EDP has privileged access to actual and potential gas consumers (as all gas customers are also electricity customers), as well as on the

³⁸⁶ See agreed minutes of the meeting with CNE of 7.9.2004.

³⁸⁷ Agreed minutes of meeting with Iberdrola on 8.9.2004.

³⁸⁸ EDF's reply to the Commission's questionnaire of 17.9.2004.

customer base of Portgás. It also has the chance to use the same commercial organisation to sell electricity and gas. Energy players stressed that the ability to rely on a very large customer base and to use common sales forces allows a substantial lowering of the commercial cost of each end-customer. According to Iberdrola: "[...]* *Gas and electricity supply have many features in common: the distribution channel are the same or very similar, the customer base is roughly the same. The brand is also a very important factor for the customers, in particular smaller customers. Gas and electricity brands are clearly associated as brands relating to energy suppliers. Having a strong brand in one sector (e.g. electricity) provides a significant advantage in the other sector (e.g. gas) and vice-versa. Customers favour dual-fuel offer because (i) the two products are closely linked for them (energy services) and (ii) it reduces the number of interlocutors: one supplier, one call centre, etc...*"³⁸⁹

571. For its part, BP stresses that "(t)he incumbent electricity distributor enjoys the competitive advantages derived inter alia from, for example, its Customer base (customer access and economies of scale), customer intimacy (can build more focussed Customer value Propositions)"³⁹⁰.
572. The advantage derived from operating an electricity network is also emphasised by International Power, which is quite active in Portugal: "*The different timing of the liberalisation in the gas and the electricity market can be an advantage for EDP as well, because, being the incumbent electricity distribution company and therefore doing the mandatory technical inspections, they are already in contact with the customers.*"³⁹¹

Dual fuel offers

573. EDP would also have enjoyed a significant advantage as a multi-utility operator being able to make dual offers of electricity and gas in order to gain new gas customers³⁹². The British³⁹³ and the Spanish experience show that electricity companies have entered into gas supply and have been successful with a dual fuel offer. "*According to Iberdrola, the dual-fuel offer is the main engine of the market development. This has been witnessed in Spain and is very likely to happen in a similar way in Portugal. For the time being, [...]* of Iberdrola's contracts are dual-fuel contracts. This proportion is much higher as regards new customers gained by Iberdrola*"³⁹⁴.
574. As a matter of fact, the Commission's investigation confirms that gas and electricity customers set a high value on dual fuel offers when choosing an energy supplier. As explained by a gas player: "*Besides, customers definitely favour being able to source both gas and electricity from the same energy supplier (dual-fuel offer). EDP can easily rely on its unmatched customer base in Portugal (electricity customers) and leverage on it to develop effectively a gas business and makes the entry of other*

³⁸⁹ Agreed minutes of meeting with Iberdrola on 8.9.2004.

³⁹⁰ BP's reply to the Commission's questionnaire of 17.9.2004.

³⁹¹ Agreed minutes of meeting with International Power on 14.9.2004.

³⁹² See "Study on electricity and gas markets in Portugal", Final Report, Cambridge Economic Policy Associates Ltd, for the Autoridade da Concorrência, April 2004, page 42. This competitive advantage does not apply to the supply to LDCs.

³⁹³ E-mail of 30.9.2004 by Centrica.

³⁹⁴ Agreed minutes of meeting with Iberdrola on 8.9.2004

*competitors more costly and lengthy: competitors will have to develop both gas and electricity activities in Portugal*³⁹⁵.

Brand strength

575. Finally, unlike other foreign potential entrants, EDP has a well-known national brand as an energy player, both at national and at local level. All Portuguese electricity customers (who are, at the same time also, potential gas customers) can therefore associate EDP with an established and reliable national energy operator. It is therefore not only the brand itself which is the advantage but also the reputational advantage of the household name in energy and the proven technical competence which is of high importance. The Commission's investigation confirms that this is a very important factor for customers when choosing a gas or electricity supplier³⁹⁶.

Advantages due to EDP's position in, and information on gas retailing in Portugal

576. EDP's entry in the gas retail markets is further illustrated, not only by its experience in Spain where it had already acquired, in 2003, the second Spanish gas operator Naturcorp through its subsidiary Hidrocantabrico³⁹⁷, but also by its recent acquisition of joint control in a large LDC such as Portgás.

577. In this respect it should be noted that, absent the merger, Portgás would have been the only gas supplier independent of GDP already established in Portugal. At the moment of the market opening, it would have therefore been the only company ready to compete immediately and effectively for the supply of gas to small customers. This source of competition is eliminated by the merger.

578. Furthermore, the fact that EDP has recently acquired joint control over Portgás and could obtain around [60-70]*% [...] gives EDP additional advantages. First, the position of a regional incumbent is in itself a huge advantage even in an environment opened up to competition. Indeed, as an incumbent local supplier and given the low switching rate of the retail customers, EDP could have developed its gas activities on the basis of Portgás' significant customer base in the area of Porto. Currently, this LDC supplies [10-20]*% of the customers, representing [20-30]*% of the national sales volume. Such a customer base would already have allowed EDP to operate profitably in the market and to have a strong foothold in the newly opened national market.

579. Through Portgás and through its Spanish natural gas business, EDP would also have increased its expertise and credibility in natural gas supply. The Spanish gas incumbent, Gas Natural, underlined the competitive advantage afforded by being a gas distributor and operating a gas distribution network to enter the gas retail market: "The acquisition of a local distributor is very important to expand in the gas business, also because it gives access to the necessary know-how. In this respect it is important to

³⁹⁵ Agreed minutes of meeting with [...] on 27.8.2004

³⁹⁶ By far the most important criterion for LDC gas customers (mostly small industrials) responding to the Commission's market investigation was the local sales force and the technical support, followed by existing relations and strong a brand in Portugal. Only two companies were seen as credible suppliers: EDP and Gas Natural (Commission's phase II market investigation, customer questionnaire.)

³⁹⁷ As indicated above, until recently, EDP had joint control over Hidrocantábrico (see Case COMP/M.2684-EnBW/EDP/Cajastur/Hidrocantábrico). On 9.9 2004 the Commission then authorised EDP's acquisition of sole control over this company.

notice that three of the four electricity companies that entered the gas markets in Spain (the only exception is Iberdrola) control one or more local distributors"³⁹⁸.

580. Absent the merger, and in addition to the significant advantages already enjoyed by EDP as the national electricity incumbent, Portgás would have been an important starting point in successfully developing its activities in the Portuguese gas market.

581. This was underlined recently by the Portuguese competition authority in the context of the assessment of the acquisition of joint control by EDP in Portgás in the following terms:

“In addition, when the liberalization of the natural gas market takes place, and considering the entire national territory, EDP’s entry into the activity of low pressure natural gas in the north littoral region may also mean the entry of a potential competitor of GDP into this activity, if continued separation between EDP and GDP is assumed.”³⁹⁹

582. It is important to point out that the fact that, following the opening of the market, Portgás’ distribution and supply activities would have had to be unbundled⁴⁰⁰, would have given an additional impetus to EDP to market its gas product and its combined gas and electricity product in the whole of Portugal which it could have done from a far better starting base than any other alleged potential competitor

583. Indeed, as a result of such unbundling, EDP/Portgás would, on the one hand, have supplied gas to customers through the supply company stemming from the unbundling while, on the other hand, keeping regional control over the distribution network of Portgás. The control of such distribution network would have been crucial for EDP in order to keep customers and gain new ones for the following reasons.

584. As was explained by CNE, the Spanish regulator, “Relying on an incumbent distribution company confers *significant commercial advantage in both electricity and gas*”. CNE underlined in this respect that :

“In addition to the fact that a distribution company has access to all crucial information about the customers (address, consumption, etc.), it also has regular contacts with the customers. This put the distribution company in a better position at the moment in which the customer becomes free to choose its supplier to either stay with the distribution company within the regulated market or switch to the trading arm of its group, being one of the first to propose a discount off the tariff. In gas, the distribution company has contacts in particular through the technical inspections which are made for new installations (i.e. new clients) and then regularly during the lifetime of the installation. In electricity, only distributors are allowed to make these inspections even if the customers switched to the liberalised market with a competing supplier (but periodical inspections are not required as they are in gas). In gas, the first inspection is done by the distributor and the subsequent inspections can be done either by the distributor or by the new supplier. However, ensuring this service requires a lot of staff and is often sub-contracted to the incumbent distributor (which

³⁹⁸ Agreed minutes of meeting with Gas Natural on 08.09.2004

³⁹⁹ Decisão do Conselho da Autoridade da concorrência, 24 september 2004 [“92 Acresce que, aquando da liberalização do mercado do gás natural, e considerando todo o território nacional, a entrada da EDP na actividade de distribuição de gás natural a baixa pressão na região litoral norte, poderá significar a entrada de um potencial concorrente da GDP nesta actividade, assumindo uma continuada separação entre a EDP e a GDP.”]

⁴⁰⁰ As mentioned, Article 13 of the Second Gas Directive provides for the legal unbundling of Distribution System Operators.

has the staff already). As a result, the distributor keeps the contacts with the customers. Other barriers can be the service and the costs for emergency services. The distributor and the new supplier have to negotiate the price of such sub-contracted services. This could be an additional barrier to entry for new suppliers and several new suppliers have complained that the incumbent charged very high prices for this negotiated services, thus raising the overall cost of gaining new customers."⁴⁰¹ (Emphasis supplied)

585. The strategic importance of the distribution network is confirmed by [...] ⁴⁰².
586. In addition to the strong advantages already held due to its position as electricity incumbent, EDP would have been in a position to rely on Portgás' specific relationship with its gas customers in order to immediately become the most effective and significant competitor of GDP.
587. In addition to all these features which make EDP intrinsically the best placed player to challenge GDP, it must be pointed out that EDP's ability and incentive to enter the gas retail market was all the more credible in that, prior to the merger, it was already in charge of the metering, billing and invoicing activity, both for the electricity and the gas consumption⁴⁰³ in the area of Lisbon, the largest distribution area in natural gas (Lisboagás).
588. This would clearly have given EDP an additional important advantage vis-à-vis other potential entrants given the size of this distribution area, considering that this allows a direct contact and a specific knowledge of the customers' profile (consumption profile, solvency, credit terms, pricing conditions etc.).

Given its strong incentives, EDP could have been expected to enter/expand in the market

589. As outlined above, EDP had the ability and very strong advantages in entering, and expanding in, the gas market. These advantages were combined with strong incentives to do so.
590. [...] ⁴⁰⁴.
591. This is not surprising given that there would have been strong economic incentives for doing so as substantial synergies exist between supply activities in gas and electricity. These are linked, *inter alia*, to cost savings concerning customer contacts (such as call centers), metering and billing and to cost savings concerning branding.
592. Further strong economic incentives for entering into gas operations were mentioned above. A CCGT operator can achieve cost savings and other advantages for the operation of its plant by gaining additional flexibility in the management of its gas supply contract.
593. Portgás would have added further economic incentives: it is clear that the larger the natural gas business of the non-regulated supplier, such as the one that will stem from Portgás, the lower the costs per customer and per unit sold. The development of a purely local brand would not make economic sense in the context of a non-regulated supplier.

⁴⁰¹ Agreed minutes of meeting with CNE of 7.9.2004.

⁴⁰² [...]

⁴⁰³ See answer to question 2 of the Commission's Article 11 letter of 19.8.2004.

⁴⁰⁴ [...]

594. There would finally have been the strategic incentive of the pre-emptive move vis-à-vis the most likely other company being able to make dual fuel offers, GDP and other potential entrants into the supply of natural gas to small customers.
595. EDP's position vis-à-vis GDP has been confirmed by most respondents⁴⁰⁵: the Commission asks gas and electricity players to indicate which company would be the most likely one to enter the gas retail business in Portugal. EDP is the company which was cited the most often in top position. Many industry players have confirmed the strong economic and strategic rationale for a company like EDP to enter into the retail supply of gas to small customers.

EDP's elimination as an immediate and potential competitor would strengthen the dominant position of GDP and raise entry barriers further

596. There are limited sources for potential competition in electricity and gas supply to small customers in Portugal (as elsewhere in Europe). In view of the facts outlined it is evident that EDP would be the most likely potential competitor (and, through Portgás, would be the only immediate competitor) of GDP. The elimination of such a competitor would have serious consequences for competition for small customers of natural gas in Portugal and would lead to those customers' paying higher prices and obtaining a lower quality service.
597. Contrary to the parties' view, the elimination of EDP as a significant potential competitor will not be compensated by the fact that GDP intends to sell to Iberdrola, in exchange for its exit from the capital of GALP⁴⁰⁶, its participation in two small LDC, Beiragás and Tagusgás. Even if this transfer were to be finalised, Iberdrola would not be in a position to become a competitor comparable to EDP absent the merger given that the two small LDC together do not reach a [...] * of Portgás' performance in terms of clients supplied (they supply approximately [0-10] *% of the customers) and account for a tenth of Portgás' performance in terms of sales' volume (approximately [0-10] *% of the national sales' volume). Iberdrola explained, in particular, that it "*would have liked to get larger LDCs as a counterpart for exiting Galp, Tagusgas and Beiragas account for about [0-10] *% of gas distribution in Portugal and do not allow Iberdrola to reach the critical mass in the gas retail markets. In particular, it seems quite difficult to use this base to efficiently develop in other areas in Portugal. These are rural areas where it is difficult and more expensive to develop the network: just developing the network in these areas requires large investments*"⁴⁰⁷.
598. Finally, the Commission considers that, in addition to eliminating EDP as the most effective and likely competitor absent the merger, the proposed concentration will further deter entry on the Portuguese retail market. As already explained in the context of the assessment of the effects of the concentration on the electricity retail markets, EDP/GDP will remain the only company able to propose, within a relatively short time period, dual-fuel offers to Portuguese customers; on the other hand, the merger, both companies would have been in a position to do so for the benefit of consumers. This unique advantage enjoyed by the merged entity after the transaction is further confirmed [...] *⁴⁰⁸

⁴⁰⁵ Second general Art. 11 request sent to competitors, September 2004

⁴⁰⁶ At the moment Iberdrola has a 5% financial participation in GALP.

⁴⁰⁷ See agreed minutes of the meeting with Iberdrola of 8.9.2004.

⁴⁰⁸ [...]

599. The Commission notes that, even if the geographic market for the supply of gas to small customers should remain local for a longer period than expected, this would not change the analysis and the finding of a strengthening of a dominant position. In this case, GDP's dominance would indeed be further strengthened in the five distribution areas controlled by its subsidiaries through the elimination of EDP which, for the reasons already stated above, would have been GDP's most significant potential competitor absent the merger. GDP's LDCs account for around [70-80]*% of demand and include, in particular, major urban and industrial areas (Lisbon; Coimbra; Aveiro; Leira; Setubal). Therefore, the strengthening of GDP's dominant position in these areas would, as a result, significantly impede effective competition in a substantial part of the common market⁴⁰⁹. Conversely, if the geographic market were to be considered local, EDP/Portgás' dominant position in the area of Porto would also be strengthened thanks to the elimination of GDP which, being the dominant incumbent in all other gas markets, would become⁴¹⁰ the most likely and significant potential competitor in this area, absent the merger.

Conclusion

600. On the basis of the abovementioned elements, the Commission considers that the concentration would remove GDP's main potential competitor and further the barriers to entry in the market for the supply of gas to small customers.

601. In its reply to the statement of objections, ENI indicates explicitly that the parties acknowledge⁴¹¹ the Commission's concerns, expressed above (paragraphs 559 to 599).

602. It can therefore be concluded that the concentration as notified will strengthen GDP's dominant position in the market for the supply of natural gas to small customers, as a result of which effective competition will be significantly impeded within the meaning of Article 2(3) of the Merger Regulation.

C. Other arguments put forward by the parties

603. As explained above, the concentration in question is part of a broader operation whereby the oil (Petrogal) and gas (GDP) activities of Galp are to be separated, and the high-pressure gas network is to be spun off to REN. In the same time frame, the Portuguese government was expected to open to competition, sooner than expected, the market for the supply of natural gas to power producers (CCGTs and dual-fuel power plants). The parties argue⁴¹² that these measures are pro-competitive and should be taken into account when assessing the overall impact of the proposed operation on competition.

604. As regards the separation of natural gas and oil, the parties contend that these two forms of energy are competing with each other as they can be substituted for one another in numerous applications. Accordingly, the parties consider that, "post-Transaction, Eni and EDP will have stronger incentives than GALP currently does, to focus on the development of the *natural gas business in full competition with oil*"⁴¹³. However, the Commission does not share the view that the development of gas in

⁴⁰⁹ See, for instance, Case C-179/90, *Merci convenzionali Porto di Genova*, [1991] ECR. I-5889, paragraph 15.

⁴¹⁰ [...].

⁴¹¹ See ENI's reply to the statement of objections at paragraph 160.

⁴¹² Parties' position paper, 9.8.2004.

⁴¹³ Parties' position paper, 9.8.2004

Portugal should be considered to be pro-competitive in itself since, on the other hand, as shown by the extent of the concerns raised by the operation, the proposed merger will strengthen GDP's already dominant position on the different Portuguese gas markets, to the detriment of competition and therefore consumers.

605. As regards the ownership unbundling of the gas network, transferred to REN, the parties argue that such total unbundling is not required by the gas directives. Indeed, the Second Gas Directive only requires that the high-pressure gas network be legally unbundled from commercial gas supply activities, along with non-discriminatory and transparently regulated third-party access. The parties state⁴¹⁴ that “*ownership unbundling of the Network is inherently pro-competitive*” and “*represents the ultimate guarantee for any potential new entrants in the liberalised segments*”. The Commission first notes that, given the terms of the binding agreements, such ownership unbundling will occur only over more than [...] months. Secondly, it notes that its scope and effectiveness are questionable in the present case. In particular, it must be recalled that the most strategic assets which allow the importation of gas into Portugal (Sinès LNG terminal and the Algeria-Portugal import pipeline) or the storage of gas (for example, such as the underground storage in Carriço) will remain owned and controlled by GDP. It must also be underlined that EDP plans to retain a substantial share in REN (30%) which may, in specific circumstances, allow it to exert some influence over the company's policy and management of the network. In this respect, the Commission notes that, in other Member States, the reason for which energy players are not allowed to keep minority shareholdings exceeding 5% is precisely to avoid the maintenance of strong structural links with the network manager.
606. As regards the Portuguese government's stated intention to anticipate the opening of the natural gas sector, the Commission is of the view that its pro-competitive effect is doubtful in the particular circumstances of the case. Indeed, given that, as a result of the merger, GDP's dominant position will be strengthened on various Portuguese natural gas markets, the opening of the market to competition, although formally anticipated, risks being rendered ineffective for the future, to the detriment of consumers.
607. In view of these factors and of the seriousness of the concerns identified by the Commission, the arguments brought forward by the parties cannot invalidate the preliminary conclusion that the operation is not compatible with the common market within the meaning of Article 2 of the Merger Regulation.
608. The findings above (paragraphs 603 - 607) have not been disputed by the parties in their replies to the statement of objections.

D. Conclusion on the competitive assessment of the notified operation

609. For those reasons, the Commission has come to the conclusion that the notified concentration will strengthen (i) EDP's dominant position on the markets for wholesale electricity, retail electricity supply to large industrial customers, retail supply to LV customers and ancillary services in Portugal and (ii) GDP's dominant position on the markets for the supply of natural gas to CCGTs, local gas distribution companies (LDCs), large industrial customers and also to small customers in Portugal, as a result of which effective competition will be significantly impeded in the common market and in the EEA within the meaning of Article 2(3) of the Merger Regulation.

⁴¹⁴ The parties' submission on 9.8.2004.

VI. DESCRIPTION OF THE REMEDIES PROPOSED BY THE PARTIES ON 28 OCTOBER 2004

610. On 28 October 2004, the parties proposed remedies in the following terms.

A. Sale to REN of the Sinès LNG re-gasification terminal

611. The Parties commit to sell, or procure the sale of, the Sinès LNG re-gasification terminal (the “Terminal”), currently owned and operated by Transgás Atlantico, as a viable business -- including also the relevant staff and ancillary infrastructures, -- to REN – Rede Eléctrica Nacional, S.A. (“REN”). The sale shall be carried out in accordance with the provisions of Clause 11 and Schedule III of the Agreement entered into by EDP, Eni and REN (the “REN agreement”)⁴¹⁵, and shall occur either through the sale of 100% of the share capital of Transgás Atlantico, currently held by Transgás SGPS, or in another form such as to achieve a tax optimization. The sale shall also comply with the provisions relating to the transfer of assets which have benefited from EU funding. The sale shall take place within 9 months after the adoption, by the Portuguese Authorities, of all the legislation and/or regulations setting forth the rules necessary for the operation and remuneration of the regulated re-gasification activities, provided that all the required authorizations have been obtained.
612. The Parties also commit to procure that, for the period between the time when the Portuguese law implementing the EC Directive concerning common rules for the internal market in natural gas comes into force and the time of the sale of the Terminal, Transgás S.A. puts in place a provisional re-gasification code setting out appropriate guarantees for third party’s access based on transparent and non-discriminatory criteria with respect to the available capacity (i.e., the total technical capacity less the capacity needed by Transgás S.A. to off-take LNG under its LNG supply agreements already in place at the date hereof).
613. The Parties also commit to terminate, or to procure to terminate, the tolling agreement entered into by Transgás S.A. and Transgás Atlantico, pursuant to which [...]*, at the time of the sale of the Terminal to REN. Simultaneously, Transgás S.A. and Transgás Atlantico, or the REN’s subsidiary operating the Terminal, shall enter into a new agreement pursuant to which Transgás S.A. will have thereby the right to unload, store and re-gasify at the Terminal only the quantities of LNG necessary for it to comply with its LNG supply agreements already in place at the date hereof (as already detailed to the Commission during the proceedings), for the entire duration of these agreements (including any possible extension set forth thereof).⁴¹⁶ Under this agreement, Transgás S.A. shall also be granted a proper modulation service -- to be agreed between the parties both acting as prudent operators in the gas industry -- in order to supply the Portuguese market. The terms and conditions of this agreement shall be those set up by the relevant legislation and/or regulations.
614. Should the legislation and/or regulations setting forth the rules necessary for the operation of the regulated re-gasification activities provide for this possibility, GDP reserves the right to retain, directly or indirectly, a minority non-controlling interest in

⁴¹⁵ Schedule III of the REN agreement is attached as Exhibit 1 to the parties’ 28 October 2004 remedies.

⁴¹⁶ These agreements are: [...]

Transgás Atlantico, or in the REN's subsidiary operating the Terminal, to the extent and under the conditions set forth by the relevant legislation and/or regulations.

B. SALE TO REN OF THE CARRIÇO UNDERGROUND STORAGE FACILITY

615. The Parties commit to sell, or procure the sale of, the Carriço natural gas underground storage facility as a viable business -- including also the two storage caverns already planned and under construction, but not yet completed, the relevant staff and ancillary infrastructures -- currently owned by Transgás S.A. (the "Carriço Facility"), to REN. The sale shall be carried out in accordance with the provisions of Clause 11 and Schedule III of the REN Agreement and in a form such as to achieve a tax optimization and to comply with the provisions relating to the transfer of assets which have benefited from EU funding. The sale shall take place within 9 months after the adoption, by the Portuguese Authorities, of the legislation and/or regulations setting forth the rules concerning the minimum strategic storage requirements of the Portuguese System and the use by third parties of strategic and operating storage capacity, provided that all the required authorizations have been obtained.
616. Transgás S.A. shall retain the right of use over a certain share of the underground strategic storage capacity such as to allow it to comply with its obligations in this regard as will be set forth by the applicable legislation and/or regulations that shall be adopted by the Portuguese Authorities. Consistently, Transgás S.A. shall also have a right of use over a share of the available operating storage capacity which shall be proportional to its strategic storage capacity commitment.
617. The above-described rights of use shall be granted to Transgás S.A. through a long-term storage service agreement to be entered with REN at the same time of the sale of the Carriço Facility to REN. With regard to those storage services that will be subject to Third Party Access ("TPA") rules, the terms and conditions shall be those set up by the relevant legislation and/or regulations. With regard, on the other hand, to those storage services that will not be subject to TPA rules (for example, the operating storage services that might be subject to negotiated access), if any, the terms and conditions shall be negotiated between Transgás S.A. and REN on an arm's length and non-discriminatory basis.

C. Guarantees for access to the Network pending publication of the relevant TPA rules

618. The Parties commit to procure that, for the period between the time when the Portuguese law implementing the EC Directive concerning common rules for the internal market in natural gas comes into force and the time of the sale of the Network (as defined in the REN Agreement) to REN, Transgás S.A. puts in place a provisional network code setting out appropriate guarantees for third party's access based on transparent and non-discriminatory criteria.

D. Release to REN of the capacity at the Campo Maior entry point currently booked and unused by Transgás S.A.

619. The Parties commit that, at the same time of the transfer of the Network to REN, Transgás S.A. shall release to REN the capacity currently booked and unused by Transgás S.A. at the Campo Maior entry point which amounts to [...]cm/h corresponding to [300-350]* million cm/y. Following the transfer of the Network to REN, the latter will be the owner and the operator of the Campo Maior entry point.

This is so because the Network includes, inter alia, the Campo Maior - Leiria – Braga pipeline as well as Transgás S.A. participation in the company Gasoduto Campo Maior - Leiria – Braga holding the exclusive transportation rights over the pipeline. Consequently, the release of capacity shall take place through the reduction of the capacity booked by Transgás S.A. under the existing shipping contract with the company Gasoduto Campo Maior - Leiria – Braga.

E. Commitment not to book further capacity at the Campo Maior entry point

620. The Parties commit that Transgás S.A., or any other undertaking controlled by GDP or by each of the Parties,⁴¹⁷ shall not book and use any further transportation capacity at the Campo Maior entry point, including the capacity (amounting to [300-400]* million cm/y) currently booked by Enagas and that might be released once the El-Ferrol LNG Terminal starts its operations, from the date the Transaction is approved by the Commission until 36 months after the adoption of TPA rules for access to transportation infrastructures in Portugal, or until new entry capacity – for the benefit of gas suppliers other than Transgás S.A. (and any other undertaking controlled by GDP or by each of the Parties⁴¹⁸) -- through pipelines is created in Portugal, whichever is the earliest.
621. However, Transgás S.A., or any other undertaking controlled by GDP or by each of the Parties⁴¹⁹, shall remain able to request REN -- pursuant to the TPA rules defined for the utilization of such infrastructure by third parties -- to book and use available transportation capacity at the Campo Maior entry point on a short-term basis if required in order to supply the Portuguese market.

F. Commitment not to book further capacity on the Extremadura pipeline

622. The capacity currently available to Transgás S.A. on the Extremadura pipeline -- pursuant to the long-term ship-or-pay agreement it has concluded with the pipeline company holding the exclusive transportation rights on the pipeline, *i.e.*, Gasoducto Extremadura -- is that strictly necessary to comply with its long-term, ToP natural gas supply agreement with Sonatrach, already in place at the date hereof.
623. A third party wishing to book and use transportation capacity over the pipeline will address its request to Enagas, the Spanish TSO, pursuant to Spanish TPA rules. In order to satisfy the request, Enagas might use, depending on the availability, either the capacity it has booked pursuant to its existing long-term ship-or-pay agreement with the pipeline company, or the available excess capacity, *i.e.*, that in excess of the capacity booked respectively by Transgás S.A. and Enagas pursuant to their respective long-term ship-or-pay agreements, if any.
624. If Enagas plans to book part or all of the available excess capacity on a long-term basis, it shall request it to the pipeline company, in its capacity of shareholder of the company. In such case, however, the pipeline company is under an obligation to ask Transgás S.A., as the other shareholder of the pipeline company, whether it also wishes to book part or all of the available excess capacity. If Transgás S.A. does so and the sum of the respective requests exceeds the available excess capacity, the latter shall be

⁴¹⁷ This means all undertakings solely controlled by each of EDP and Eni.

⁴¹⁸ This means all undertakings solely controlled by each of EDP and Eni.

⁴¹⁹ This means all undertakings solely controlled by each of EDP and Eni.

allocated between Enagas and Transgás S.A. on a pro-rata basis (*i.e.*, [40-50]*% to Enagas and [50-60]*% to Transgás S.A.).

625. With regard to the above, the Parties commit that Transgás S.A., or any other undertaking controlled by GDP or by each of the Parties,⁴²⁰ shall not book and use part of, or all, the existing excess capacity on the Extremadura pipeline from the date of the clearance of the Transaction by the Commission until 36 months after the adoption of TPA rules for access to transportation infrastructures in Portugal, or until new capacity is created on this pipeline (or new import pipelines into Portugal are built) for the benefit of gas suppliers other than Transgás S.A. (and any other undertaking controlled by GDP or by each of the Parties⁴²¹), whichever is the earliest. As a consequence, the existing excess capacity, if any, will be entirely available to Enagas.
626. However, Transgás S.A., or any other undertaking controlled by GDP or by each of the Parties⁴²², shall remain able to request the pipeline company to book and use existing excess transportation capacity, if any, on the Extremadura pipeline on a short-term basis if required in order to supply the Portuguese market.

G. Elimination of GDP’s right of first refusal, based on a “matching the best offer mechanism”, [...]*

627. The Parties commit to amend the Shareholders’ Agreement, before the closing of the Transaction, by [...]*

H. measures aimed at eliminating concerns related to possible privileged access to price information

628. EDP undertakes that persons responsible for the operational management of the electricity generation, wholesale or retail businesses shall not participate in the executive management bodies of the natural gas wholesale and retail supply businesses. In addition, the Parties commit to ensure that persons responsible for the operational management of the electricity generation, wholesale or retail businesses shall not obtain from GDP, or any of its subsidiaries, any information concerning natural gas prices charged to power producers, other than EDP, located in Portugal.

I. Measures aimed at ensuring scope for the effective liberalisation of the demand represented by large industrial customers (“LICs”)

629. The Parties commit that Transgás S.A. shall give to those LICs whose natural gas supply contracts will expire in the period between the clearance of the Transaction and the adoption of the legislative measures providing for the liberalisation of natural gas supply to LICs, the possibility to renew their natural gas supply contracts on a yearly basis.

J. Commitment to sell to a viable buyer one or more supply companies controlled by gdp or by any of the Parties

⁴²⁰ This means all undertakings solely controlled by each of EDP and Eni.

⁴²¹ This means all undertakings solely controlled by each of EDP and Eni.

⁴²² This means all undertakings solely controlled by each of EDP and Eni.

630. As stated above, the Parties understand that the Portuguese Government is ready to commit *vis-à-vis* the Commission to liberalize natural gas supply to small industrial, commercial, and household customers (the “Natural Gas Retail Supply”) by 2008.
631. In such framework, the Parties commit to implement, or to procure the implementation of, the legal unbundling of each of the local distribution companies (the “LDCs”) that will be controlled by GDP or by any of the Parties, as provided for in the Gas directive, 3 months before the date of the entry into force of the legislative and/or regulatory measures providing for the effective liberalisation of Natural Gas Retail Supply (the “Effective Date”).
632. In the event that 24 months after the Effective Date (the “Reference Date”), the aggregate market share of third parties in terms of customers (the “Aggregate Market Share”) is lower than the current market share of Portgás, the Parties commit to sell, or to procure the sale of, one or more of the supply companies controlled by GDP or by any of the Parties and stemming from the legal unbundling of the LDCs, such as to allow third parties to immediately reach the above-mentioned position in the market. The sale, to a viable buyer, shall take place within 12 months from the Reference Date.
633. The Aggregate Market Share shall be calculated by an independent consultancy firm approved by the Commission.

K. Commitment not to engage in dual offers of natural gas and electricity to LICs and retail customers in Portugal until the natural gas supply to such customer groups is liberalized

634. EDP, both as an electricity supplier and as a controlling shareholder of GDP, and Eni, as a controlling shareholder of GDP, commit not to engage in dual offers of natural gas and electricity to LICs in Portugal until the natural gas supply to such customers is liberalized.
635. Likewise, EDP, both as an electricity supplier and as a controlling shareholder of GDP, and Eni, as a controlling shareholder of GDP, commit not to engage in dual offers of natural gas and electricity to retail customers in Portugal until the natural gas supply to such customers is liberalized.

L. Reduction of EDP’s participation in REN from 30% to around 5%

636. EDP commits to reduce its participation in REN from 30% to around 5% at fair value in the context of the foreseen IPO of REN announced by the Government for 2005.
637. In addition, EDP commits not to designate members to REN’s Board of Directors, nor to exercise the voting rights attached to its participation in the shareholders’ meeting of REN, until the reduction of its participation in REN is implemented.

M. Moratorium concerning the construction of new CCGTs

638. EDP accepts a moratorium concerning the construction of new CCGTs in Portugal (in addition to the third group of TER), in order to incentivate the entrance of new players in the Portuguese electricity market, and thus also creating gas demand for power producing, until January 2008 or until one year after the date that two additional groups not controlled by EDP received the adequate license (*licença de estabelecimento*) from DGGE – *Direcção Geral de Geologia e Energia*, whatever date is the earliest.

N. Commitment to implement the lease of TER

639. EDP commits to lease production capacity to a third party, that will have the option to nominate energy, in order to bring forward the entrance of additional independent players in the Portuguese electricity market.
640. EDP will execute the capacity lease through negotiations to find a viable lessee. In the event that a viable leaser is not found until 3 months after the receipt from the Commission of the decision declaring the Transaction compatible with the common market, the lease shall be implemented through a limited tender managed by a Trustee chosen by the Commission from a list of three proposed by EDP.
641. The generation capacity to be leased is equivalent to one group of TER (392 MW). The third party who will contract the lease with EDP will pay a capacity fee, reflecting the total fixed costs of a standard CCGT in Portugal (including fixed O&M and investment costs) and the standard variable costs, excluding gas (for example, variable O&M, CO₂).
642. Gas requirements will be subject to a gas supply contract, to be signed between EDP and the acquirer, which will be defined on a back-to-back basis with the current EDP CCGT gas supply contract. With this contract, the lessee will assume the ACQ, Take or Pay and additional quantities as foreseen in the referred contract and will benefit from the proportional flexibility.
643. The power production capacity lease will start three months following the end of the PPAs or within the 6 months following the notification of the Commission's decision approving the transaction, whatever date is the earliest, and will last until June 2008. By January 2008, EDP may submit to the Commission a reasoned request to bring this commitment to an end. In that case, the Commission will verify whether one of the competitive conditions outlined below is already met: i) two additional groups not controlled by EDP have been constructed or are under construction or ii) the difference of the average of the zonal wholesale prices (Portugal and Spain) in 2007 is below 10% or iii) Mibel is implemented and as declared by the Portuguese Energy Regulator – ERSE, liquidity is not a constraint in the electricity wholesale market..
644. If none of the competitive conditions listed in previous paragraph is met, a new lease of TER in above-mentioned terms will be implemented until but no later than June 2010.

O. Commitment to sell EDP's participation in Tejo Energia

645. EDP undertakes to sell its participation in Tejo Energia, under neutral financial conditions, to a viable Buyer, based on a minimum price defined according to the “fair value” of EDP's share in Tejo Energia.
646. The fair value above-mentioned shall include the value of CMECs and all the rights included in the Tejo Energia Shareholders Agreements (namely [...]*), the value of licenses or projects related with new investments, as well as all the transaction costs associated with the divesture.
647. The process to sell EDP's stake in Tejo Energia will start one month after the Transaction is cleared by the Commission, being the closing date dependent just on the conclusion of the negotiations in relation to the CMECs between the Portuguese Government and Tejo Energia, which is a process not controlled by EDP.

P. Commitment to suspend voting rights and to appoint independent Board Members in Turbogás

648. EDP is willing to commit to suspend its voting rights in Turbogás, immediately after the Transaction is cleared by the Commission and for a three years period, in two specific areas: (a) acquisitions of natural gas; and (b) decisions of new investments.
649. EDP undertakes to replace EDP's representatives in the Board of Directors of Turbogás by independent persons of recognized reputation during the above mentioned period of time that should act to protect EDP's financial position in the Company.

VII.ASSESSMENT OF THE REMEDIES PROPOSED BY THE PARTIES ON 28 OCTOBER 2004

A. Electricity markets

1. Wholesale electricity market

(a) Strengthening of EDP's dominant position as a result of horizontal effects

650. As regards the horizontal effects of the operation, the Commission has come to the conclusion that the merger will eliminate GDP as a significant potential competitor, since the latter was very likely to successfully enter the electricity wholesale market in Portugal (for example, building a CCGT) and to compete with EDP.
651. In order to eliminate the horizontal effects of the operation on the electricity wholesale market in Portugal, the parties have proposed commitments aimed at allowing other players to develop their activity in the wholesale electricity market (commitments M, N, O, P).

Moratorium concerning the construction of new CCGTs and capacity lease on TER (commitments M and N)

652. The parties' proposal consist in a combination of measures aimed at ensuring the entry of competitors while, at the same time, avoiding the divestment of generation assets.
653. Respondents to the Commission's market test considered these proposals as clearly insufficient in terms of scale, scope and duration to compensate for the significant loss of GDP as a potential competitor and to effectively ensure the timely entry of potential competitors.
654. As regards the proposal to lease production capacity from TER, some market participants found that such a measure was not acceptable in principle and that a divestiture of generation assets should rather be considered. In that respect, it was argued that a lease would not ensure effective competition on the market because it is only a transitional measure which would not create any threat to EDP's reinforced dominant position and would not allow the development of a real competitor. In particular, EDP will know both the quantity and the cost of the energy that the lessee will bring to the market every hour. It was also underlined that a lease would create considerable gas price risk for the lessee company which would be dependent upon EDP's supply contracts.

655. Other respondents were not opposed to a lease as such, combined with other measures, provided that substantial improvements to the proposed commitment were made. Indeed, respondents to the Commission's market test underlined that, in any event, the proposed leasing measure is clearly insufficient in several respects.
656. First, in terms of scale and scope, market players underlined that the generation capacity to be leased (392 MW) is minimal. Many respondents pointed out to the fact that this would only correspond to 4-5% of the total generation capacity in Portugal. In that respect, it was argued that the lease should at least correspond to 1200 MW, equal to the whole of TER. Other respondents put forward higher figures (namely 25 to 40% of the current generation capacity in Portugal).
657. Second, in terms of duration, market players indicated that the proposed measure would create significant uncertainty for the lessee as there would be no fixed period of time for the lease. In addition, respondents considered that the period of three years for which the lease would possibly apply (until June 2008) was far too short.
658. Finally, it was also underlined that a lease can only be considered to be acceptable if the lessee is a stable operator in Portugal and has the ability and the incentive to develop its activities in the long run.
659. As regards the proposed moratorium (commitment M), respondents put forward the following arguments. First, it was strongly argued that the duration of the moratorium was too short as it would last for a maximum period of three years. Respondents also underlined that the moratorium would not ensure effective entry of competitors since it would not end as from the effective "construction" of a CCGT, but as from the mere reception of a licence. Some respondents indicated that the moratorium should, in any event, last until 2010 at least. Most respondents considered that, if not fixed for a predetermined duration, the moratorium should end when new CCGTs are effectively operational on the market. Secondly, in terms of size and scope, the envisaged moratorium was perceived as quite insufficient.
660. The Commission shares the above concerns expressed by third parties. It is all the more necessary to ensure that the proposed moratorium and lease are sufficient in scale, duration and scope in as much as commitments which are structural in nature are, as a rule, preferable and do not, moreover, require medium and long-term monitoring measures⁴²³. In addition, excessive details as to how the price of the lease will be established greatly reduce the likelihood to find a lessee which can exercise a real competitive constraint.
661. In addition to the above concerns, the Commission is of the opinion that the proposed commitments are also insufficient for the following reasons.
662. As concerns the "lease" proposed by the parties, it is important to note that it does not consist in the actual leasing of a unit of TER to a third party whereby the latter would operate the plant autonomously and, in particular, would be free to procure its gas input from the existing contracts or from alternative sources. The proposal merely consists in allowing a third party to ask for electricity from EDP at the production price of TER and up to a volume equivalent to one unit of TER. As a result, not only does the volume of electricity proposed account for merely 4% of the installed capacity in Portugal, but the lessee would not be in a position to manage on its own this (limited)

⁴²³ See Case T-102/96, Gencor v. Commission [1999] ECR II-753, at paragraph 316, and Commission's Notice of March 2001 on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 447/98 (OJ C 68, 2.3.2001 p. 3) at paragraph 9.

production capacity. In particular, the lessee will not be able to source gas supplies at more competitive prices from suppliers other than the merged entity. In addition, such a lease is likely to create problems of information flows, as EDP will have extensive knowledge of how the lessee will decide to dispatch its third of the plant (volumes and underlying costs), thereby conferring on EDP a significant information advantage. Since EDP will keep operating the whole plant, the lessee will remain strongly dependent on EDP and will not have the ability to have a significant influence on the market.

663. Besides, the duration of the lease would not only be highly uncertain, as explained above, but would also require extensive monitoring from the Commission. Indeed, the proposal provides that, by January 2008, the parties could ask the Commission to bring the commitment to an end subject to the fulfilment of some alternative conditions. According to the proposal, the Commission would have to verify, for instance, that the difference between average wholesale prices in Portugal and Spain in 2007 was below 10%, or that Mibel is implemented and that “liquidity is not a constraint in the electricity wholesale market” according to the Portuguese energy regulator, ERSE. If one of these conditions were to be met, the commitment would be brought to an end. In addition, such conditions would require an extensive verification from the Commission and would clearly put at risk legal certainty given their vague wording and the lack of clarity of the criteria set out therein. In that respect, the proposed remedies also depart significantly from the advantages provided by a clear-cut structural remedy.
664. It should also be noted that the conditions proposed by the parties to bring the lease to an end (and one of them is enough to stop the lease) seem implicitly to refer to the appearance of an Iberian market, which might justify the end of the relevant remedies according to the parties. However, none of the above-mentioned conditions guarantees that the market will be wider than national in scope: (i) As explained at length in the geographic market definition, the implementation of the MIBEL in itself does not ensure that the electricity wholesale market will be Iberian in scope (because of frequent congestions, lack of regulatory harmonisation of the electricity markets and diverging regulations (stranded costs and CO₂ NAP)). (ii) The liquidity of the wholesale market is a vague criterion which relates only very indirectly to imports from Spain. (iii) A difference in average prices below 10% between Spain and Portugal does not say much as to whether or not the markets are integrated. Indeed, underlying costs (such as fuel-oil, gas, coal) tend to be similar from one country to another on average, so that it is possible to find countries where average prices in a given year have not been very different from those prevailing in Portugal. As an illustration, the parties have never contested that the Commission’s findings that the electricity wholesale market was currently limited to Portugal. However, in 2003, the difference between average prices in Portugal and in Spain was below 10%, despite the fact that these prices fluctuated in a highly uncorrelated manner, with differences ranging from 20% to more than 40%. In these conditions, according to the parties’ proposal, the lease would have been terminated while the market is still Portuguese in scope and no competitor has entered.
665. With respect to the proposed moratorium, the Commission is of the view that it would not ensure the timely entry of effective competitors to EDP on the wholesale market. Indeed, the moratorium only refers to “two additional groups” (two units). Given that CCGTs are usually composed of at least two groups, one new CCGT would therefore be enough to stop the moratorium. Besides, as already explained above, the proposed moratorium would fall either in January 2008 or one year after a “licence” has been granted, rather than when a new CCGT is operational. As a result, the proposed

undertaking does not ensure that competitors would have effectively entered the market at the moment at which the moratorium would expire given that the construction of a CCGT may not take place at all following the delivery of a licence and, in any event, takes several years after such delivery.

666. While the event triggering the end of the moratorium is clear (delivery of a license for two groups), the obligations imposed by the moratorium are vague: the parties mention only that they “*accept a moratorium concerning the construction of new CCGTs in Portugal*”. It is unclear whether this really means that EDP will not start building CCGTs as long as the moratorium is in place. EDP may simply interpret this commitment as an undertaking not to start the operation of new CCGTs, which would mean that EDP could still start building CCGTs during the moratorium. This could be very detrimental to new entries since (i) the moratorium would not really represent a significant advance for competitors and (ii) the mere fact of building a CCGT may deter competitors from starting similar projects or at least significantly delay competing projects.

Commitment to sell EDP’s participation in Tejo Energia (commitment O)

667. In addition to the above-mentioned moratorium and lease, the parties propose to divest themselves of EDP’s 10% share in Tejo Energia.
668. The Commission is of the view that the divestiture of EDP’s 10% share in Tejo Energia would, in principle, be a positive move to the extent that it would sever the links of EDP with one of its competitors and [...]*
669. However, this commitment does not, as such, ensure that Tejo Energia will effectively develop a CCGT in the near future. [...]*, it remains that, in any event, the project to build a new CCGT remains on hold because of conflicting views amongst other shareholders and because of uncertainties as regards the financing⁴²⁴. It is also worth noting that the two major shareholders, International Power and Endesa, each have other agreements with EDP relating to Portuguese power production (see, respectively, at paragraphs 287 and 324) which may keep them from acting independently from EDP.
670. Besides, the wording of the remedy proposal makes this divestiture very uncertain. First, the divestiture is made subject to the requirement of a minimum price defined according to the “fair value” of EDP’s share which includes numerous items. Secondly, as was underlined by a market respondent, the deadline for the effective completion by EDP of the sale of its minority shareholding remains excessive and uncertain as it is made dependent on the conclusion of negotiations with the Portuguese government for the award of CMECs. Even with respect to the sale of this minority share, there is

⁴²⁴ See the agreed minutes of a meeting with International Power of 19.9.2004, where is explained that: “Discussions are ongoing with [...] in order to determine how the project may be structured and which entities are willing to bear market risk. [...] appear willing to take merchant risk (i.e. to use this CCGT to supply directly the electricity wholesale market), but not [...], which wants the CCGT to operate under a tolling agreement so that it does not bear merchant risk on its potential investment. [...] wants this CCGT to work like [...] and to provide a guaranteed return on investment. Contrary to [...] and [...], [...] has not demonstrated a real interest in developing the generation capacities of [...]. There is a general consensus among the [...] that the project has competitive advantages over alternative potential green field developments but more information is needed about what the liberalised market will look like (market implementation) before taking a decision on the project. Right now there are too many uncertainties”.

therefore no effective commitment from EDP to complete the transaction within a short time period.

Commitment to suspend voting rights and to appoint independent Board Members in Turbogás (commitment P)

671. The parties have also proposed to suspend EDP's voting rights in Turbogás for a three-year period in two specific areas: (i) the acquisition of natural gas, and (ii) the adoption of decisions on new investments.
672. As such, this remedy does not sever the links between EDP and Turbogás over the long term since it is of limited scope and of limited duration.
673. Besides, it was never alleged, nor established, that Turbogás was effectively considering building a new CCGT in the short term and would therefore exert an additional competitive constraint on EDP.
674. It follows that, even if Turbogás were no longer prevented from developing a new gas-fired power plant, this proposed remedy does not ensure that it will actually be the case in the near future.
675. For all the reasons mentioned above (paragraphs 650 to 674), the proposed remedies are therefore unsuitable and insufficient to eliminate the horizontal effects brought about by the transaction and the resulting strengthening of EDP's dominant position on the wholesale electricity market.

(b) Strengthening of EDP's dominant position as a result of non-horizontal effects

676. As regards the non-horizontal effects of the operation, the Commission has come to the conclusion that the notified merger will strengthen EDP's dominant position in the electricity wholesale market for each of the following distinct reasons. Further to the notified operation, the merged entity will have:
 - (i) privileged and preferential access to the Portuguese gas infrastructure (Sinès LNG terminal, import pipeline and Carriço underground storage);
 - (ii) the ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry.
 - (iii) the ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs;
 - (iv) access to proprietary information about its competitors' costs, conferring it a significant advantage;
 - (v) access to the daily gas nomination of its main competitors, conferring on it a significant advantage;

EDP's privileged and preferential access to the Portuguese gas infrastructure (commitments A-F, L)

Sinès LNG terminal and access to the network (commitment A)

677. The replies of competitors, regulators and transmission system operators on the proposed sale of the Sinès LNG terminal were generally positive. Respondents argued

that the measure, if combined with well-functioning TPA rules, is likely to facilitate imports by third parties.

678. However, respondents also pointed out that there are a number of weaknesses in the commitment that bring a significant risk of rendering the commitment ineffective, or at the very least of significantly reducing or unduly delaying its effectiveness. These concerns are as follows:

- (i) Regarding the timing of the divestment it was underlined that the date envisaged is too uncertain and too late as it would only take place, according to the parties' proposal "*9 months after the adoption, by the Portuguese authorities, of all the legislation and/or regulations setting forth the rules necessary for the operation and remuneration of the regulated re-gasification activities, provided that all the required authorizations have been obtained*". Such a proposal does not allow prospective entrants to rely on a fixed time-table. It also departs significantly from the requirement set out by the Commission's Notice on remedies⁴²⁵ that "*the deadline for the divestment should start on the day of the adoption of the Commission decision*" as it exclusively depends on the adoption of (rather unspecified) measures by the Portuguese government. Divestment should therefore occur within a fixed time period after the adoption of the Commission decision. In any case, there is no reason to condition the transfer of the terminal upon the regulatory definition of TPA since (a) booking has to be made in advance and (b) as soon as the operator of the terminal has a neutral position, access can be negotiated.
- (ii) Regarding the proposed provisional re-gasification code (and the provisional network code) respondents strongly argued in favour of its approval by the Portuguese regulator ERSE in order to ensure that it is non-discriminatory. ERSE should also be in a position to monitor their application. For the same reasons as outlined under (i) it was argued that it is necessary that such provisional codes enter into force as soon as possible after the Commission decision as potential entrants need to plan their gas supply well in advance of actual entry.
- (iii) Regarding the provision that the parties are to conclude an agreement with REN on a modulation service to be provided to GDP, it was objected that such special agreement risks undermining the non-discriminatory character of access to the Sinès LNG terminal. It would have to be ensured that a modulation service is available to third parties on the same terms and conditions.
- (iv) Regarding GDP's continued minority participation in Transgás Atlantico or any other legal entity operating the LNG terminal, third parties were less concerned with the amount of the participation than with the rights attached to it. Third parties argued that the parties should hold no special voting rights, there should be no parties' board member and the parties should hold no special veto rights, in particular concerning day-to-day management.
- (v) Respondents also argued that additional rules such as the use-it-or-lose-it principle should be added to the normal TPA so as to ensure that the incumbent does not have the ability to book capacity beyond its real needs. This rule might

⁴²⁵ Commission Notice on remedies acceptable under Council Regulation No 4064/89, at paragraph 48.

be combined with a penalty payment for unused capacity, providing additional safeguards.

- (vi) This commitment does not apply to jointly-controlled subsidiaries of ENI (such as Unión Fenosa Gas) and EDP (such as Naturcorp), which could use the capacity expected to be made available to independent third parties⁴²⁶.
- (vii) Many conditions and constraints are included in the commitment to transfer the LNG terminal: securing all the required authorizations, achieving the sale in accordance with certain provisions of the REN agreement and with the rules applying to the transfer of assets which have benefited from EU funding. All these elements undermine the effectiveness of the commitments, as they create additional uncertainties as to the likelihood of their successful and timely implementation by the parties. Moreover, they require extensive monitoring by the Commission.

679. In view of these comments the Commission finds that, for the reasons outlined by third parties, this commitment A may have a positive effect on entry in Portuguese gas markets and in the Portuguese electricity wholesale market if the weaknesses outlined are eliminated. However, the currently proposed detailed provisions of the commitments make it possible to prevent, significantly reduce or delay the remedy's effectiveness. This considerable risk thus severely reduces the remedy's potential positive effects.

Carriço underground storage (Commitment B)

680. The replies of competitors, regulators and transmission system operators on the proposed sale of the Carriço underground storage were generally positive, although respondents expressed substantial doubts on how much working capacity would actually be available for third parties at the Carriço underground storage and therefore how useful the storage would actually be for new entrants. Nevertheless, the high potential importance of the Carriço underground storage as one of very few means available in Portugal to achieve flexibility and modulation of supply was widely acknowledged. Respondents argued that the measure, if combined with well-functioning, non-discriminatory TPA rules, could facilitate entry by third parties.
681. However, respondents also pointed out that there are a number of weaknesses in the commitment that bring a significant risk of rendering the commitment ineffective, or at the very least of significantly reducing or delaying its effectiveness. These concerns are similar to the ones outlined regarding the Sinès LNG terminal, as summarised below:
- (i) Regarding the timing of the divestment, the concerns were identical to the ones outlined above on the Sinès LNG terminal divestment, namely that the timing is uncertain and far too remote as there is no fixed deadline measured from the adoption of the Commission decision.
 - (ii) Unlike for the LNG terminal, no provisional access code has been proposed by the parties for the underground storage
 - (iii) Regarding the provision that the parties are to conclude an agreement with REN on a share of the available operating capacity third parties voiced concerns that

⁴²⁶ [...] [...]

this would in the end give preference to the parties over their competitors and run counter to the principle of non-discriminatory access at the same terms and conditions.

- (iv) A ‘use-it-or-lose-it’ principle should be included to ensure an effective TPA to infrastructure. It might be combined with a penalty payment for unused capacity providing additional safeguards.
- (v) Conditions and constraints included in the commitments and which are external obligations upon the parties should be removed as they create additional uncertainties.

682. In view of these comments the Commission finds that, for the reasons outlined by third parties, this commitment may have a positive effect on entry into Portuguese gas markets and in the Portuguese electricity wholesale market if the weaknesses outlined are eliminated. However, as the currently proposed detailed provisions of the commitments make it possible to defeat, significantly reduce or delay the remedy’s effectiveness this considerable risk also severely reduces the remedy’s potential positive effects.

683. In view of these comments the Commission finds that, although this commitment B may have a positive effect on entry in Portuguese gas markets and in the Portuguese electricity wholesale market, the weaknesses outlined above are serious and may defeat, significantly reduce or delay the remedy’s effectiveness. This considerable risk thus severely reduces the remedy’s potential positive effects.

Guarantees for Access to the network pending the publication of the relevant TPA rules (Commitment C)

684. As regards the provisional network code for the Network, described in point C of the proposed remedies of 28 October 2004, the conclusion is similar to that relating to the LNG terminal (see paragraph 678, (ii)):

- (i) The code should be approved and enforced by the regulator to ensure that it is efficient and non-discriminatory;
- (ii) The code should be put in place as soon as possible and at a fixed date after the decision of the Commission so as to allow third parties to prepare the opening of the market;

685. There are therefore uncertainties as to whether the parties’ proposal (commitments C) will actually be effective.

Campo Maior / Extremadura pipeline (Commitments D, E, F)

686. The capacity to be made accessible to third parties at Campo Maior, which represents [10-20]*% of overall transport capacity, was found to be too small by a substantial number of respondents to the Commission’s market test. Respondents outlined that such capacity was less than what would be needed to fuel a single 400 MW unit of a CCGT.

687. In addition, the parties have not undertaken to free any capacity in the upstream pipeline (Extremadura) located in Spain and which allows gas to be brought up to the Portuguese border, at Campo Maior. On the contrary, GDP has retained the entirety of its shares and transport rights in the company which manages the upstream pipeline

(Gasoduto Extremadura). There is therefore no certainty that capacity will be available for third parties to bring gas up to the Portuguese border to benefit from the capacity made available from the Portuguese border. The Spanish regulator and transmission system operator pointed out that this would be all the more likely as Spanish rules favour national deliveries over international transit when there are congestions. The restrictions relating to international transit, however, do not apply to such transit as the one carried out by Transgás on the basis of its Sonatrach contract through the Maghreb pipeline because these rights precede the applicable Spanish regulation, putting GDP at an additional advantage vis-à-vis other deliveries to Portugal coming from or through Spain.

688. The contracts defining the rules for the transport of gas in each relevant section of the international pipeline contain specific clauses depending on the country and the capacity rights used to transport gas. [...]*. Even if the compatibility of such agreements with Article 81 of the Treaty might be questioned⁴²⁷, this clause creates at least as great an uncertainty as for the possibility of using Enagás' capacity to supply the Portuguese market⁴²⁸. It is therefore at least doubtful that third parties would be entitled to use Enagás' transport rights to sell gas in Portugal.
689. There are also clear concerns on the effectiveness of the commitments not to book further capacity at Campo Maior or in the Extremadura pipeline. Firstly, it is not certain that spare capacity would be available apart from the capacity booked by GDP. In particular, contrary to what the parties imply, Enagás has confirmed that it did not plan to release the capacity it currently uses to supply Galicia through Portugal, even after the launch of the El Ferrol terminal. Secondly, this commitment does not apply to jointly-controlled subsidiaries of ENI (such Unión Fenósa Gas) and EDP (such as Naturcorp), which could use the capacity expected to be made available to independent third parties. Thirdly, Transgás still reserves itself the right to book further capacity on a short-term basis. This possibility is broadly defined and allows the parties to decrease further the capacity which could normally be used by third parties. Fourthly, this commitment will last no more than a few years (three years after the adoption of TPA rules) which is very short with respect to gas contracts. This may not allow gas suppliers to rely on this capacity for longer-term activities. Lastly, this commitment lapses as soon as "*new entry capacity [...] through pipelines is created in Portugal*". But the parties⁴²⁹ are aware that Enagás has already asked for the extension of the capacity in the Extremadura pipeline for its own needs in Spain. Therefore, this commitment will fall almost immediately, while there is no certainty that a significant part of this extra capacity will be available for third parties.
690. In view of the small available capacity and the numerous hurdles in using it, a number of participants have pointed out that a substantial gas release programme should be necessary in Portugal, modelled on the Spanish gas release programme at the time of the opening of the Spanish market to competition as a more effective, and potentially

⁴²⁷ [...]

⁴²⁸ It should be mentioned that it is doubtful that Enagás or other gas operators would engage in a time consuming and resource intensive legal battle to challenge this clause.

⁴²⁹ Enagás' request was presented on the board of Gasoduto Extremadura, whose GDP/Transgás is the other main shareholder.

complementary, measure. The gas release in Spain consisted in releasing 25% of the Algerian gas contract of the gas incumbent along with a market share cap⁴³⁰.

691. The market test has also confirmed that capacity on the pipeline connection between Spain and Portugal is very important for competition and cannot be fully replaced by available capacity at the LNG terminal, as the pipeline provides additional flexibility, directly links Spanish and Portuguese markets and thus has the potential of reducing the required critical size of entry.
692. Given the insufficient available capacity proposed by the parties and the great uncertainty as to the basic effectiveness of this commitment, given the terms and conditions attached thereto, the proposal of substantial gas release programmes along with the related transport capacities appears to be one of the few possibilities to compensate for this lack of capacity.
693. In light of the above, the Commission concludes that the current proposal of the parties (commitments D, E & F) is likely to have very limited, if any, positive effects on natural gas markets and the electricity wholesale market in Portugal.

Reduction of EDP's share in REN (commitment L)

694. The reduction of EDP's share in REN is viewed as having a positive impact on non-discriminatory TPA to (gas and electricity) infrastructure. Respondents, however, underlined that no special voting rights should be retained by EDP, no Board member should be nominated by or with the necessary consent of EDP, and no special veto rights, particularly on issues of management, should be attached to EDP's shareholding. The Commission shares these views as, in the absence of such commitments, this remedy would be ineffective.

Conclusion on commitments relating to infrastructures and transport rights (A-F, L)

695. In light of all the elements described above relating to the commitments A to F and L, the Commission has therefore come to the conclusion that, even though the transfer of these infrastructures and of some transports rights to REN is a positive commitment, numerous issues remain which do not ensure that these commitments will actually be effective and allow a timely entry of sufficient volumes of gas by competitors.

EDP's ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry.

696. As explained above, various concerns and uncertainties arise from the parties' commitments (A-F, L) relating to the transfer of infrastructure and transport rights to REN. Considering also the uncertainties as to the timing of the advanced liberalisation of the market for the supply of gas to CCGTs (see above), these commitments do not ensure with a sufficient level of certainty that actual and future CCGTs, if any, will be in a position to source natural gas from other gas companies at competitive conditions. Respondents have also underlined that the remedies proposed so far have not solved

⁴³⁰ Spain introduced a gas release programme for 25% of the gas supplies that Spain receives from Algeria through the Maghreb pipeline from 2001 to 2004. Participation was conditional on the tender demonstrating plans for securing gas in another way once the release programme finished. Fourteen licensed gas traders submitted bids, of which six were allocated volumes (BP, Iberdrola, Unión Fenosa, Endesa, Hidrocarbónico, and Shell). The average price paid by bidders was equivalent to the incumbent's purchasing cost plus a fixed management fee.

the present concern. Thus, the Spanish regulator stated :*“there is a clear risk that this may happen, even with the proposed measures”*⁴³¹

697. Therefore, further to the merger and despite the proposed remedies, EDP will have ability and incentive to control gas prices and raise its rivals’ costs, thereby foreclosing its actual and potential competitors and deterring entry. As a result, EDP’s dominant position on the electricity wholesale market will be further strengthened.

EDP’s ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs

698. For this concern, the replies from the market test and the conclusion of the Commission are similar to what has been described in the section above: the high uncertainties as to the effectiveness of the transfer of infrastructures and transport rights to REN do not ensure that the gas requirements of actual and potential competitors will be addressed and managed by a company other than the merged entity.
699. Besides, even if the proposed transfer to REN were effective, EDP would still manage the gas supply of most of Turbogás’ gas requirements (long-term gas contract). The proposed remedies therefore do not reduce EDP’s ability to manage the gas supply to the detriment of its main competitor in Portugal.
700. Therefore, despite the remedies and for the reasons explained in paragraphs 698 to 699, the merger strengthens EDP’s dominant position on the electricity wholesale market.

EDP’s access to proprietary information about its competitors’ costs, conferring on it a significant advantage

701. To address this issue, the parties have proposed to erect Chinese Walls between certain parts of EDP and GDP and on certain matters (Commitment H). In this respect, respondents to the market test expressed strong reserves as to the effectiveness of such measures. For instance, the Spanish regulator stated that : *“It is difficult to believe that “Chinese walls” can work properly when there are very few contracts, whose conditions can be easily communicated by any informal communication mean.”*⁴³² Indeed, gas prices in contracts are defined by a formula which links them to a basket of publicly available indexes (petroleum products). Knowing the parameters in the formula, just once, allows the price paid by the CCGT every day for several years to be calculated.
702. Given the long-lasting consequences of accessing this information even once, Chinese Walls do not seem to ensure with a sufficient degree of certainty that EDP will not become aware of its competitors’ costs. The proposed remedies therefore do not satisfactorily remove the strengthening of EDP’s dominant position in the electricity wholesale market, owing to EDP’s ability to access proprietary information about its competitors’ costs.

EDP’s access to the daily gas nomination of its main competitors, conferring on it a significant advantage;

703. As underlined by respondents, the Chinese Walls proposed by the parties do not cover the daily gas nominations of EDP’s competitors and therefore do not address the

⁴³¹ CNE’s reply on 5.11.2004

⁴³² CNE’s reply on 5.11.2004

strengthening of EDP's dominant position in the electricity wholesale market due to EDP's ability to access proprietary information about its competitors' costs.

2. Market for ancillary services

704. The commitments N (lease of a part of TER), M (moratorium), O (sales of EDP's shares in Tejo Energia) and P (suspension of EDP's voting rights in Turbogás) relate to electricity generation. The Commission has therefore analysed to what extent these remedies may address the competition concerns identified in the market for ancillary services that is to say, may compensate for the loss of potential competition by GDP.
705. However, as was explained at paragraph 650 et seq., these commitments do not ensure with a sufficient level of certainty that competitors will build new power generation capacities in Portugal in the near future.
706. In addition, respondents have underlined that the lease of TER, as proposed by the parties, did not allow the lessee to take part in the market for ancillary services. Indeed, this market requires almost real-time adaptation of the plant output to ensure the balancing of the electricity network. This requires operating the plant and is incompatible with the nomination of energy in advance (possibly daily nominations) that is planned in the proposed remedies. Irrespective of the above, the lease of TER may stop before new generation capacity has been built in Portugal, thus leaving EDP uncontested in the market for ancillary services.
707. Hence, this remedy does not ensure the entry of new competitors on the market for ancillary services to compensate for the loss of GDP. It does not reduce the strengthening of EDP's dominant position in the market for ancillary services.

3. Retail supply of electricity

708. In the retail supply of electricity, the Commission has pointed out that the merger would (i) remove GDP as a strong competitor and (ii) raise further barriers to entry, as new entrants would have to enter both gas and electricity retail markets.
709. Many respondents to the market test have underlined that the remedy package falls far short of solving the concerns identified in the retail electricity market. Indeed, the only remedy which relates directly to the retail supply of electricity is commitment K: "*commitment not to engage in dual offers of natural gas and electricity to retail customers until the natural gas supply to such customer groups is liberalised*". First, the meaning of this remedy is unclear since after the merger, the merged entity will supply customer with both gas and electricity. Secondly, the parties' commitment would only apply for a limited period as it would end from the legal opening of the gas market.
710. As stressed by respondents, the package of remedies does not compensate for the loss of GDP's future competition. The only remedy relating directly to electricity retail (commitment K above) does not in itself ensure or significantly foster the appearance of competitors as well placed as GDP to successfully launch an electricity retail business.
711. The Commission nevertheless considered whether other remedies could, indirectly, have a positive impact on the retail electricity market.
712. First, it has been examined whether the divestiture of gas retail supply companies may be seen as offering a starting point for the acquirer to sell electricity at the retail level. However, the timing of this possible divestiture (between 2011 and 2013 if it happens

at all), to which one should add the time necessary to enter the electricity market, is too remote to compensate the loss in good time. Besides, if gas supply companies are divested, they will account for less than [10-20]*% of the current number of gas customers in Portugal. This customer base is far smaller than the one on which GDP could have relied to enter the electricity market, absent the merger.

713. Secondly, it was also considered that new electricity retailers might come from new entrants in power generation (wholesale market). However, the investigation carried out by the Commission has shown that the launch of new CCGTs in Portugal in the foreseeable future (e.g. before 2010) was very unlikely. As explained above, the remedies proposed by the parties do not ensure with a sufficient degree of certainty that new CCGTs will be built in this timeframe. The lease of TER, because it is very limited in time, cannot be relied upon to successfully launch a retail business.
714. Therefore, the remedies do not ensure that new competitors will effectively enter the retail supply of electricity in Portugal in a timely manner so as to compensate for the loss of GDP's future competition. Consequently, the proposed remedies do not remove the strengthening of EDP's dominant position in the retail supply of electricity.

B. Natural Gas markets

1. Gas supply to power producers

715. With regard to the market for gas supply to power producers, the respondents to the Commission's questionnaire generally pointed out that the proposed remedies (commitments G, M, O, P) are not sufficient to eliminate or compensate the customer foreclosure effect of the concentration. In their view more effective and far-reaching measures should be needed for this purpose.
716. The Commission shares this view.
717. First, as far as TER's and EDP dual fuel plant's short term requirements are concerned, the Commission notes that the elimination GDP's right of first refusal (commitment G) does not change EDP's incentives, after the concentration, to buy gas from GDP rather than from independent suppliers. The anticompetitive effect of the concentration will therefore not be eliminated.
718. Secondly, concerning Turbogás' short-term requirements, EDP's commitment to suspend its voting rights in Turbogás and to appoint independent Board Members (commitment P) does not appear sufficient to eliminate the customer foreclosure.
719. Indeed, as underlined by several respondents to the Commission's questionnaire, EDP will probably maintain a significant influence on Turbogás' decisions, given that (i) the "independence" of the board members appointed by EDP would not be guaranteed at all; (ii) EDP would suspend its voting rights only as to the acquisitions of natural gas and new investments, but would continue to vote on other important issues and would therefore maintain some negotiating power on the choice of gas supplier and, (iii) the suspension of the voting rights would only last for a limited time of three years. Besides, the implementation of this purely behavioural remedy would be extremely difficult to monitor in practice without the continued and careful assistance of the other shareholders of Turbogás.

720. In the light of these considerations, it can thus be concluded that the foreclosure of the existing gas demand as a result of the merger will not be eliminated by the proposed remedies.
721. As is indicated above, it is highly uncertain that this anti-competitive effect will be alleviated in the short to medium term by the development of new demand following the construction of new CCGTs in Portugal. In this respect, it does not appear that the abovementioned suspension of EDP's voting rights on Turbogás new investments (commitment P), the proposed sale of EDP's participation in Tejo Energia (commitment O) and the proposed moratorium concerning the construction of new CCGTs (commitment M) would be sufficient to significantly change the situation.
722. As for the suspension of EDP's voting rights in Turbogás, in addition to the problems already indicated on the effectiveness of this remedy, it should be underlined that there are no indications (nor did the parties ever claim) that this company might build a new CCGT in Portugal.
723. Concerning the sale of EDP's participation in Tejo Energia, the Commission acknowledges that this would eliminate an important obstacle to the possible development by this company of a new CCGT project. However, as already explained, the requirement of a minimum price defined according to the "fair value" of EDP's share and the conditional link with the conclusion of the negotiations in relation to the CMEC's between the Portuguese Government and Tejo Energia make this divestiture very uncertain. In any event, it should be noted that, as has already been explained, irrespective of the obstacle represented by EDP's interests, an agreement on the development of a new CCGT has not been reached among the other shareholders of Tejo Energia and there are still many uncertainties in this regard.
724. Finally, as for the moratorium concerning the construction of new CCGTs, it has already been explained, that, in the terms proposed by the parties, this measure would not effectively and significantly foster the development of new projects.
725. Regarding the commitments relating to gas infrastructure (commitments A-F and L), the inefficacy of these remedies has been pointed out above. Anyway, even if such remedies were fully effective, it should be pointed out that they would only very indirectly address the competition problem at stake, as they do not in themselves create new demand. Appraisal of the remedies therefore does not change the finding that the remedy package proposed by the parties is insufficient to remedy the strengthening of a dominant position on the market for the supply of natural gas to power producers.

2. Gas supply to LDCs

726. Respondents to the Commission's market test strongly rejected the main proposed measure (the sale of one or more supply companies, Commitment J) as insufficient and un-timely. The criticism was based on a number of arguments:
- (i) Market participants argued that the scope of the divestiture should be at the very least the equivalent of Portgás in terms of volume, whereas the conditional divestment proposed by the parties would only cover, if implemented, the much lower Portgás market share in terms of customers. The divestment, even if it were finally to take place, would thus fall short of sufficiently remedying the competition concern of customer foreclosure.
- (ii) The eventual divestiture should cover not just the supply company or companies but also the distribution company or companies. Even though having been legally

unbundled by the distribution companies, as required by the Second Gas Directive, the parties' supply companies would indeed have a substantial advantage vis-à-vis such divested supply companies in terms of customer confidence and relationships. This would bear a strong risk of reducing the divested supply companies' economic viability and subsequent deterioration of their market position (and therefore also of their consumption). Some market participants also proposed to divest not only the LDCs but also the corresponding supply contracts to these LDCs.

(iii) It was strongly argued that the divestment should be unconditional and implemented at the same time as the merger. In any event the proposed implementation, up to 33 months after liberalisation of natural gas supply to customers of LDCs, does not address the customer foreclosure effect, which sets in much earlier.

727. In the Commission's view the criticism expressed by these market participants is justified. The proposed remedy therefore fails to address adequately the competition problem of the strengthening of GDP's dominance on the market for supply of natural gas to LDCs. As for the timing of the proposed divestiture, the Commission also stresses that it departs significantly from the requirement set out by the Commission's Notice on remedies, where it is stated that "*the deadline for the divestment should start on the day of the adoption of the Commission decision*".

728. This assessment is not altered by taking into consideration the commitments proposed on infrastructure discussed above. Beside the above comments on their inefficacy, it should be noted that these commitments, while having a general potential for facilitating entry, do not eliminate or compensate the foreclosure of LDC's demand. Furthermore, they cannot actually and significantly facilitate entry into this market, since it will be – to a very large extent - foreclosed to competition and since little new demand will arise through new entry due to limited customer switching rates among customers of LDCs.

3. Gas supply to large industrial customers

729. The response by market participants, regulators and transmission system operators to the proposed remedies in the Commission's market test was in general rather skeptical on the proposed remedies (see in particular commitments I, relating to the possibility of a yearly prolongation of expiring LIC contracts, K, relating to dual offers, and the gas infrastructure commitments A-F and L). A substantial number of market participants argued that the remedies did not fully address the competition problem raised by the proposed operation. In particular,

(i) the prohibition of dual sales for this customer group as long as it is not an eligible customer group in both markets was seen as an evident necessity but in itself insufficient⁴³³;

(ii) the infrastructure measures, insofar as they were seen as (potentially) effective, were found to be insufficient by many market participants;

(iii) the commitment giving those LICs whose gas contract ends between approval of the proposed concentration and liberalisation the (mere) "possibility" of renewing their natural gas supply contracts was also considered insufficient.

⁴³³ It must be noted that the scope of the commitment is not entirely clear.

730. By contrast, some market participants suggested that a cap on GDP's market share and/or gas release programmes would sufficiently address the competition problem posed by the proposed concentration.

731. In the Commission's view, the measures proposed by the parties will generally have some positive effect on potential entry into the supply of LICs in Portugal. However, considerable doubts and uncertainties remain as to whether the combined effect of such measures will sufficiently compensate for the loss of EDP as a major potential competitor⁴³⁴. The Commission notes in this context that the market test confirmed that the number of potential entrants into supply of LICs in Portugal is not particularly high and that therefore the elimination of the one of the best placed potential entrants considerably strengthens GDP's dominant position. On balance, therefore, the Commission finds that the measures proposed by the parties will not prevent the strengthening of GDP's dominant position in the market for the supply of natural gas to LICs as a result of the merger.

4. Alternative market definition: large wholesale market

732. In the part of the decision on competitive assessment the Commission has shown that, even if a wider wholesale market (comprising the supply of gas to power producers, LDCs and LICs) was considered, the notified concentration would foreclose a very large part of the challengeable gas demand. In particular, it has been shown that the foreclosure demand would have consisted of the short term requirements of EDP's gas fired power plants and Turbogás and by the gas consumption of EDP's cogenerator.

733. In this regard, it can be underlined that, as already explained (see paragraphs 717-719), the proposed remedies are not sufficient to eliminate the foreclosure of EDP's gas fired power plants and Turbogás' demand. Also, they are insufficient to eliminate the foreclosure of LDCs. Finally, they are insufficient to remedy the strengthening of GDP's dominant position in the supply of natural gas to LDCs. In addition, no remedy has been proposed to eliminate the foreclosure of EDP's cogenerator.

734. The proposed commitments would therefore not be sufficient to remedy the strengthening of a dominant position on a hypothetical large 'wholesale' market for natural gas in Portugal.

5. Gas supply to small customers

735. The remedies proposed by the parties (see in particular commitments J, relating to the sale, eventually, of one or more gas supply companies controlled by GDP, K relating to dual sales, and the infrastructure commitments A-F, L) were found to be clearly insufficient by market participants responding to the Commission's market test. Market participants found that the remedies fail to compensate for the very significant loss of GDP as a potential competitor. This is for the following reasons:

(i) The (moderate) reduction of market share determined by the possible sale (if certain conditions are met) of a supply company resulting from the unbundling of an LDC, quite apart its uncertainty, comes much too late and does not even fully compensate for the loss of Portgás' competition. Besides, it does not compensate for the additional

⁴³⁴ In this regard, it should be pointed out that in the Commission's Notice on remedies is clearly indicated that "it is the responsibility of the parties to show that the proposed remedies, once implemented, eliminate the creation or strengthening of (...) a dominant position identified by the Commission" (paragraph 6).

potential competition that, even without its acquisition of joint control in Portgás, would have emanated from EDP;

(ii) The commitment not to offer dual fuel supplies to customers which are not yet liberalised was found to be obviously necessary but clearly insufficient;

(iii) Nor were the infrastructure remedies found to sufficiently encourage entry into the supply of small customers with natural gas in Portugal.

736. Market participants suggested that LDC divestments going beyond the Portgás divestment were necessary or that a gas release programme, which is designed to encourage and facilitate entry and which might follow the Spanish model at the time of the beginning of the opening of the Spanish market to competition, was necessary.

737. The Commission shares the above concerns expressed by third parties and wishes to add the following considerations.

(i) The result of the market test again made it clear that EDP is one of very few potential entrants and is indeed the most credible and best-placed potential entrant in this market (or, if a regional market definition were to be adopted, in these markets). This underlines the need for forceful remedies in order to protect Portuguese consumers from the harmful effects the proposed concentration would otherwise have on them;

(ii) The remedies proposed by the parties entirely fail to address the necessary compensation for the elimination of Portgás' competitive constraint and of EDP as a potential competitor. In particular, they ignore the importance of Portgás and all the circumstances that (even without taking into account its joint control over this LDC) make EDP such a well-placed potential entrant, in particular EDP's access to a large customer base and EDP's brand strength with Portuguese customers;

(iii) The positive effect on entry which would be exerted by the infrastructure remedies if these remedies were working perfectly (which as shown above is not the case), would be too weak to compensate for this elimination of potential competition;

738. The proposed remedies therefore are unsuitable and insufficient to eliminate the competition concern of strengthening of GDP's dominant position on the national market for the supply to small customers (or, alternatively, on five of the six regional markets for the supply of natural gas to small customers).

VIII. DESCRIPTION OF THE SECOND SET OF REMEDIES PROPOSED BY THE PARTIES ON 17 NOVEMBER 2004

739. On 17.11.2004, the parties submitted a modified set of remedies.

740. The remedies submitted separately by EDP and ENI are summarised below. The numbering is the one used by each party in its submission :

EDP.1 : Reduction of EDP's shares in REN from 30% to 5%

EDP.2 : Divestment of EDP's shares in Tejo Energia

EDP.3 : Moratorium concerning the construction of new CCGTs subject to a review clause

EDP.4 : Lease of TER production capacity equivalent to one unit subject to a review clause

- EDP.5 : Suspension of some of EDP's voting rights in Turbogás and appointment of independent board members in Turbogás
- ENI.II : Sale of the Sinès LNG terminal to REN
- ENI.III : Sale of the Carriço underground storage to REN
- ENI.IV : Anticipated sale of the gas high-pressure network to REN
- ENI.V : Guarantees for access to the network pending sale of the network to REN
- ENI.VI : Release to REN of the capacity at the Campo Maior entry point currently booked and unused by Transgás
- ENI.VII : Commitment not to book further capacity at the Campo Maior entry point
- ENI.VIII: Commitment not to book further capacity on the Extremadura pipeline
- ENI.IX : Commitment to make capacity available on the Extremadura pipeline and/or at the Campo Maior entry point under certain conditions
- ENI.X : Elimination of GDP's right of first refusal, based on "matching the best offer mechanism".
- ENI.XI : Measures aimed at eliminating concerns related to possible privileged access to price information
- ENI.XII : Measures aimed at ensuring scope for the effective liberalisation of the demand represented by LICs
- ENI.XIII: Commitment not to engage in dual offers of natural gas and electricity to IICs and retail customers in Portugal until the natural gas supply to such customer groups is liberalized
- ENI.XIV: Sale of the LDC Setgás

IX. ASSESSMENT OF THE SECOND SET OF REMEDIES PROPOSED BY THE PARTIES ON 17 NOVEMBER 2004

A. Electricity markets

1. Wholesale electricity market

(a) Strengthening of EDP's dominant position as a result of horizontal effects

741. The new proposals submitted on 17 November 2004 in order to address the horizontal effects of the operation on the wholesale market in Portugal are not substantially different from those that were already proposed on 28 October 2004.

Moratorium concerning the construction of new CCGTs and capacity lease on TER (commitments EDP 3 and 4)

742. The parties have maintained their initial proposal to combine a moratorium with a partial capacity lease on TER, rather than to allow effective and timely entry through a structural remedy.

Moratorium

743. With regard to the proposed moratorium (EDP 3), EDP proposes not to construct new CCGTs in Portugal until 30 June 2010, except for the third 400 MW unit of TER which is to become operational in 2006.
744. Although the duration of the proposed moratorium seems longer than the previous proposal (which envisaged January 2008 as the main deadline), the duration of this commitment is, however, made subject to a review clause according to which this moratorium is automatically brought to an end if one of the following conditions is met: (i) one year has elapsed after the issuance of licenses to two new CCGT units not controlled by EDP, (ii) the difference of the weighted average of the zonal wholesale prices between Portugal and Spain for the past 12 months is below 4% according to the relevant market operator, or (iii) congestions or market splitting in the last 12 months are below 15%. Anyone of these conditions would suffice to bring the moratorium to an end earlier than 2010.
745. Similarly to the previous proposal, this commitment is far from ensuring that competitors will actually enter the Portuguese market in a timely and effective manner, in order to compensate for the loss of GDP as a significant potential competitor without the merger.
746. First, the moratorium would end [...]*. As already explained above, in particular in the light of the market test of the first remedy proposals, such a deadline would not ensure that new CCGT units are effectively operational on the market given that the construction of a CCGT unit may not take place at all following the delivery of a licence. Even if such construction is decided, the CCGT unit only becomes operational several years after the issue of the relevant licence. As a result, the moratorium could come to an end even if no competitor has actually entered the market.
747. Second, this proposal is also very inadequate in its scope. Indeed, according to this commitment, EDP would not be prevented from constructing its third TER unit whereas licences for only two additional “CCGT groups” (that is, two units) would be deemed to be sufficient to bring the moratorium to an end. Even if the commitment were to have provided that such units had to be built and operational – *quod non* – this would, in any case, represent only about 8% of the generation capacity in Portugal⁴³⁵, with no guarantee that such generation capacity would be operated by an effective and significant competitor. In particular, the remedy proposed does not provide that those CCGT units would have to be owned and operated by an independent and effective competitor, but merely that those two additional units should not be “controlled” by EDP. Consequently, the commitment does not exclude the possibility that EDP could have a link with these two additional units, for instance through some kind of agreement or coordination⁴³⁶, or a minority participation, or even that EDP could actually operate CCGT units owned by a third party.
748. Thirdly, the obligations imposed by such a moratorium do not prevent EDP from deterring effective and timely entry. According to the remedy proposal, EDP would only undertake not to “construct” a new CCGT (apart from the third unit of TER). Nevertheless, it could still obtain a licence for the construction of such CCGT, and thus

⁴³⁵ It is recalled that, on average, one CCGT group has a production capacity of 400 MW, i.e 4% of the generation capacity in Portugal.

⁴³⁶ See for instance [...]

signal to other potential competitors its intention to build a new CCGT as soon as the moratorium comes to an end.

749. With respect to the other conditions which would allow EDP to bring its commitment to an end before 2010, they create further uncertainty as to the effectiveness of the proposed remedy to ensure competitive entry in the Portuguese market. Indeed, the condition that a 4% average price-difference must exist between Spain and Portugal during a given year does not ensure the actual integration of the two markets. In particular, despite the existence of such an average over a given year, prices between Spain and Portugal could still not be correlated, thereby excluding the existence of a single geographic market in which significant competitive constraints would be exerted from Spain. As to the provision according to which the moratorium could come to an end if congestions or market splitting are below 15% during a given year, it also falls short of ensuring a sufficient level of market integration (and therefore of effective competition) between the two countries. As demonstrated above when defining the geographic market, such a level of congestion would still be lagging far behind the level of congestion prevailing in countries such as the Nordic countries⁴³⁷, for which the Commission has so far preferred not to reach a final conclusion as to whether they are part of one single geographic market or still constitute distinct markets.

Capacity lease of one unit of TER

750. As regards the commitment to implement the lease of TER (EDP 4), the parties' proposal is affected by the same drawbacks as the ones found with respect to their first remedy proposal, and underlined by the market test of the latter.
751. First, the duration of the lease would remain highly uncertain for the lessee. Although the lease would last until, but no later than, 30 June 2010, the parties would have the right to request the end of the lease as early 1 January 2008 if, in particular, "two additional CCGT groups not controlled by EDP [...] are under construction". Thus, the commitment would not even ensure that additional units are operational before the end of the lease. Besides, as for the moratorium, the remedy proposal does not provide that those CCGT units would have to be owned and operated by an effective competitor, but merely that those two additional units should not be legally "controlled" by EDP. This would not prevent EDP from having links with the owner of these units, or even from operating the units that it would not legally control. Similar remarks can also be made as for the moratorium, with respect to the other conditions that would apply for the early termination of the lease (average price difference with Spain, congestion or market splitting).
752. Second, for the same reasons as those stated with regard to the first remedy proposal, the size and the nature of the commitment would be far from sufficient to compensate for the horizontal effects brought about by the operation. Essentially, the lease would only be equivalent to the production of one unit of TER, namely 4% of the generation

⁴³⁷ It should be noted that in its decision Sydkraft/Graninge of 30.10.2003 (case COMP/M.3268, p. 26) the Commission found that Sweden was isolated from all other areas in the Nordpool area only 5,5% (2000) 0,0% (2001), 0,1% (2002), and 0,0% (Jan –Sept 2003) of the time. Isolation percentages between individual neighbouring territories and Sweden were somewhat higher but also generally low (eg. on average 7% between Sweden and Denmark East in the same period). Even though the Commission considered that the generation/wholesale market might be larger than Sweden, it left open the precise scope of the geographic market. See also the decision by the Danish Competition Authority in case Elsam/NESA. <http://www.ks.dk/konkurrence/afgoerelser/2004/R2403/elsam/> finding electricity wholesale markets no wider than Denmark.

capacity in Portugal. In addition, such a lease merely consists in a “tolling” deal whereby EDP undertakes to lease power production equivalent to one unit of TER without allowing the lessee to actually operate the unit himself, even as regards its total gas supply. Besides, such a lease would be likely to create problems of information flows as EDP would have an extensive knowledge of the lessee’s daily nominations of both gas and electricity. Lastly, the lease is of a short duration, thereby not allowing the lessee to rely thereon to develop long-term activities. As a result, the lessee will remain strongly dependent on the merged entity and will not have the ability to exert a significant influence on the market.

753. Finally, with respect to the quality of the lessee to be chosen either by EDP during the first three months from the adoption of the Commission decision, or by a trustee after that period, the criteria set out by the commitment submitted by EDP do not ensure that such lessee would have the necessary qualifications and incentives to act as an effective competitor of EDP on the market. Indeed, although the lessee would have to be approved by the Commission, EDP would only be bound to choose a lessee “unconnected to and independent of” the parties. Similarly, the lessee to be chosen by the trustee would be the company that has submitted the best offer during the tender to be organised by the trustee. Therefore, the commitment does not envisage that the lessee should be a company having experience in the electricity markets and planning to develop its activities in Portugal in the long run. As a result, EDP could very well choose a company that, although unconnected to and independent of it, is not likely to compete effectively in the market.

Conclusion on the moratorium and the lease proposed EDP

754. It follows from the above that the proposed lease and moratorium would not in themselves have an effect equivalent to a structural remedy (that is, a divestiture of generation assets) in order to allow effective and timely entry of competitors on the Portuguese wholesale market.

Commitment to sell EDP’s participation in Tejo Energia (commitment EDP.2)

755. In addition to the above-mentioned moratorium and lease, the parties propose to divest EDP’s 10% share in Tejo Energia according to principles very similar to those described in the remedies of 28 October 2004. The main modification relates to the deadline by which the sale must be implemented. Instead of being conditional upon the conclusion of negotiations on CMECs between the Portuguese government and Tejo Energia, the deadline is fixed and defined as from the decision date. The Commission’s conclusion remain the same:
756. The Commission is of the view that the divestiture of EDP’s 10% share in Tejo Energia would, in principle, be a positive move to the extent that it would sever the links of EDP with one of its competitors and that it would remove the power for EDP to block the project of a CCGT that Tejo Energia may have in the future.
757. However, this commitment does not, as such, ensure that Tejo Energia will effectively develop a CCGT in the near future for the reasons already set out above (see paragraph 669).
758. Besides, significant uncertainties remain as to whether this divestiture would eventually take place. Indeed, contrary to the divestiture of EDP’s shares in REN, the divestiture trustee is supposed to divest EDP’s shares in Tejo Energia only at a minimum price defined according to the “fair value” of EDP’s share which includes numerous items. As a result, if the price offered by a potential purchaser to the

divestiture trustee does not reach this minimum price, the divestiture trustee will not be entitled to sell these shares, thereby making the commitment ineffective.

Commitment to suspend voting rights and to appoint independent Board Members in Turbogás (commitment EDP.5)

759. As in the remedies of 28 October 2004, the parties have proposed to suspend EDP's voting rights in Turbogás for a three year period in two specific areas, namely (i) the acquisition of natural gas, and (ii) the adoption of decisions on new investments.
760. As such, this remedy does not sever the links between EDP and Turbogás over the long term since it is of limited scope and of limited duration.
761. It was never alleged, nor established, that Turbogás was effectively considering building a new CCGT in the short term. However, if Turbogás were to contemplate building a new CCGT, it is far from obvious that the mere suspension of voting on two matters would be sufficient to prevent EDP from exercising a decisive influence on these new projects, for the following reasons.
762. First, EDP will keep exercising its voting rights in other matters. EDP can therefore credibly threaten to vote in a certain way on these matters if its position is not taken into account as regards a new project.
763. Secondly, the suspension of rights is temporary while a new project will develop and need support from shareholders over a long period of time. Other shareholders may refrain from launching a new project if they know that EDP will soon exercise its rights again and will probably oppose the project.
764. Thirdly, EDP reserves the right to issue instructions to the Director Trustee "*when it is necessary to prevent a reduction in value of EDP's shareholding*", which is a clause subject to a considerable margin of interpretation and likely not to be fully countervailed by the Commission's possibility to give orders or instructions to the Director Trustee in order to ensure compliance with the conditions and obligations attached to its decision⁴³⁸.
765. Fourthly, it was brought to the Commission's attention that EDP recently acquired (26 October 2004) an option to obtain an additional 20% share in Turbogás as well as the management of the entire production capacity of the plant. This option can be exercised in the coming nine months or between 1 January 2008 and 31 December 2009. Again, the mere fact that EDP can credibly threaten to significantly increase its control over Turbogás in the future (even if a competition authority may eventually

⁴³⁸ The Commission would probably find it difficult in practice to closely monitor all Turbogás board deliberations and decisions, and especially those deliberations that are on a more informal basis and the Director Trustee will probably have a tendency to take EDP's financial interest into account to a high degree, even without explicit EDP instructions, simply by way of prior consultations with EDP. EDP, due to this 'advantage of proximity', is therefore likely to retain a significant influence over how the Director Trustee interprets its role and its obligations. Apart from the Director Trustee's written reports, the implementation of this behavioral remedy would be difficult to monitor without the continued and careful assistance of the other shareholders of Turbogás. These other shareholders (in particular International Power but also Koch Transporttechnik), however, can be expected to have a high interest in keeping good relations with EDP. Reference is on the one hand made to the tolling and share purchase option agreement between International Power and EDP. Koch Transporttechnik on the other hand is likely to be an exiting shareholder following an agreement with International Power to sell its 5% of the shares to International Power (see International Power press release of 4.11.2004; <http://www.ipplc.com/ipplc/media/newsreleases/2004/2004-11-04/>. [...])

oppose the exercise of the option) can deter other shareholders from launching a new CCGT against EDP's will.

766. It follows that this proposed remedy will not fully remove EDP's significant influence on future projects and, in any case, does not ensure that Turbogás will exert an additional competitive constraint on EDP in the near future through the development of such projects.

Conclusion as to horizontal effects on the wholesale electricity market

767. For all the reasons mentioned above, the proposed remedies are therefore unsuitable and insufficient to eliminate the horizontal effects brought about by the transaction and the resulting strengthening of EDP's dominant position on the wholesale electricity market.

(b) Strengthening of EDP's dominant position as a result of non-horizontal effects

768. As regards the non-horizontal effects of the operation, the Commission has come to the conclusion that the notified merger will strengthen EDP's dominant position in the electricity wholesale market for each of the following distinct reasons. Further to the notified operation, the merged entity will have:

- (i) privileged and preferential access to the Portuguese gas infrastructure (Sinès LNG terminal, import pipeline and Carriço underground storage);
- (ii) the ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry.
- (iii) the ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs;
- (iv) access to proprietary information about its competitors' costs, conferring on it a significant advantage;
- (v) access to the daily gas nomination of its main competitors, conferring on it a significant advantage;

EDP's privileged and preferential access to the Portuguese gas infrastructure (commitments ENI.II – IX, EDP.1)

Sale of the Sinès LNG terminal (ENI.II)

769. From a general point of view, the Commission considers that the ownership-unbundling of gas infrastructure is pro-competitive. More specifically, as compared with the remedy package of 28 October 2004, the terms and conditions attached to the transfer of the Sinès LNG terminal have been improved: the timing of the sale⁴³⁹ is clearly determined (at the latest by 31 December 2005) and most of the conditions attached to the sale of the terminal⁴⁴⁰ have been removed.

770. However, several important issues outlined by the Commission, in particular in light of the market test, remain unaddressed.

⁴³⁹ See point (i) of paragraph 678.

⁴⁴⁰ See point (vii) of paragraph 678.

771. The parties have contracted future imports of gas equivalent to [...] * bcm. They have thus argued that in the future [30-40] * % bcm would be available for third parties to import gas via the Sinès LNG terminal. It turns out that the parties will have the ability to significantly reduce the capacity actually available for third parties to import gas into Portugal.
772. Indeed, the commitment explicitly allows⁴⁴¹ jointly-controlled subsidiaries of ENI (Union Fenosa Gas) or EDP (Naturcorp) active in gas in Spain to book additional capacity in the LNG terminal even before the terminal is transferred to REN. Hence the commitment does not prevent the parties' above-mentioned Spanish subsidiaries from booking additional capacities or importing gas in Sinès, thereby foreclosing access to the terminal for independent competitors.
773. The commitment also explicitly allows⁴⁴² the parties and any subsidiary thereof to book further capacities in the terminal as soon as the terminal is transferred to REN. It is therefore possible that the parties may actually book additional capacities in Sinès the day after the transfer (on which they will have privileged information) and that they may prevent potential competitors (who might need more time to organise their entry strategy) from importing significant quantities of gas into Portugal via the LNG terminal.⁴⁴³
774. The remedy package of 17 November 2004 provides that the provisional regasification code⁴⁴⁴ will include a "use-it-or-lose-it" rule and will be submitted to the Portuguese regulator, ERSE, for comments. The code and the effectiveness of the rule can be nevertheless significantly limited since the commitment provides that it "*shall not however affect the right of Transgás S.A. to unload, store and re-gasify at the Terminal the quantities of LNG necessary for it to comply with its LNG supply agreements already in place at the date hereof, for the entire duration of the agreements (including any possible extension set forth thereof)*"⁴⁴⁵ This may prevent this rule from being applied to most of the capacity used in the terminal ([...] * bcm, corresponding to Transgás' LNG supply agreements already in place, out of 5.2bcm of total capacity).
775. In addition, the commitment does not oblige the parties to obtain the approval of the regulator on the code. ERSE will only be able to comment on the code with no possibility of challenging its content.
776. Lastly, this code will enter into force "*between the time when the Portuguese law implementing the EC Directive concerning common rules for the internal market in natural gas comes into force and the Closing [of the sale to REN]*"⁴⁴⁶. The law "implementing the EC directive" can come into force as late as 2007. However, market participants have stressed that a code would be necessary as early as possible and, in any case, well before gas liberalisation starts in Portugal since transport infrastructures need to be booked well in advance.
777. The commitments of 17 November 2004 still provide for a specific agreement between the parties and REN which grants the parties additional services such as modulation services. The market test of the first remedy proposal has underlined that such specific

⁴⁴¹ Paragraph 11 of the ENI commitments.

⁴⁴² Paragraph 20 of the ENI commitments.

⁴⁴³ As explained above, ENI [...]

⁴⁴⁴ Paragraphs 8 - 10 of the ENI commitments.

⁴⁴⁵ Paragraph 10 of the ENI commitments.

⁴⁴⁶ Paragraph 8 of the ENI commitments.

agreement concluded with REN before the transfer of the terminal could confer the parties extra advantages as compared with the access conditions of third parties. The Commission furthermore notes that also the provision in paragraph 6 c of the ENI commitments relating to the option of building a third LNG storage tank in the terminal area is at least ambiguous. The provision may be interpreted as implying that the parties retain special rights concerning additional storage capacity in Sinès.

Carriço underground storage (ENI.III)

778. As regards the transfer of the Carriço underground storage to REN, the remedy package of 17 November 2004 contains improvements similar to those of the LNG terminal, in particular with respect to the timing and the conditions attached to the sale.

779. However, important issues remain unresolved.

780. Similarly to the Sinès LNG terminal, the regulator will be able⁴⁴⁷ to comment on but with no way to oppose the provisional storage code. This code does not contain any “use-it-or-lose-it” rule. The parties undertake that the code would be applied only “*between the time when the Portuguese law implementing the EC Directive concerning common rules for the internal market in natural gas comes into force and the Closing [of the sale to REN]*”⁴⁴⁸. The code may therefore be applied too late.

781. The commitment does not guarantee any operating storage capacity to third parties. On the contrary, it provides that “*Transgás S.A. shall also have a right of use over a share of the available operating storage capacity which shall be proportional to its strategic storage capacity*”⁴⁴⁹ commitment.”⁴⁵⁰ Since Transgás is the only company which ensures the strategic storage capacity so far and is likely either to remain so or at least to remain by far the most important company assuring strategic storage in the future, the commitment, due to linking the strategic storage capacity proportionally with the operating storage capacity ensures that the parties will be able to use most – if not all – of the available underground operating storage capacity. In this regard, it should also be noted that, contrary to the remedy concerning the LNG terminal, the parties did not commit not to book further capacity in storage facility before the transfer to REN.

Anticipated sale of the network to REN and guarantees for Access to the network pending the sale of the network to REN (ENI.IV & V)

782. In the package of 17 November 2004, the parties have committed to sell the gas high-pressure gas network to REN by a fixed date (31 December 2005) possibly earlier than what was planned in the notified operation (up to 19.5 months).

783. As for the network access code, the remedy package of 17 November 2004 allows offers the regulator to comment thereon. However, ERSE will not be able to oppose or modify its content⁴⁵¹.

⁴⁴⁷ Paragraphs 28 - 29 of the ENI commitments.

⁴⁴⁸ Paragraph 28 of the ENI commitments.

⁴⁴⁹ Regulation imposes that a minimum quantity of gas should be kept always available in the underground storage as a strategic reserve.

⁴⁵⁰ Paragraph 35 of the ENI commitments.

⁴⁵¹ Paragraph 40 of the ENI commitments.

Campo Maior / Extremadura pipeline (Commitments ENI.VI – IX)

784. The commitments relating to the import of gas via the Extremadura pipeline and the Portuguese entry point (Campo Maior) are very similar to those proposed on 28 October 2004. The main modifications are the following:
785. The parties' commitment not to book further capacity applies for a period of five years from the decision date. In the 28 October 2004 package, it applied "*until 36 months after the adoption of TPA rules for access to transportation infrastructures in Portugal*"⁴⁵². A fixed date is considered as an improvement. It is however unclear which one of either wording leads to the earliest date, depending on when TPA rules will be adopted in Portugal. In any case, this commitment does not apply to Union Fenosa Gas and Naturcorp, which can thus artificially reduce the capacity available for third parties.
786. The parties also commit (ENI.IX) to possibly make up to 400Mcm/y available for third parties in Campo Maior and/or in the Extremadura pipeline under very specific conditions and for a limited period of time. More specifically, according to the commitment, additional capacity (on top of the [300-350]*Mcm/y committed at Campo Maior) up to 400Mcm/y could be provided to third parties in the Spain-Portugal pipeline if all the following conditions are met: (i) the third party has duly requested, in binding form, the capacity to the Transgás, REN or Enagás; (ii) there is no capacity available in the overall pipeline (including Enagás' capacities); (iii) two years from the first request have elapsed without the third party getting the capacity; (iv) the third party's final request to Transgás to obtain the missing capacity has been addressed within five years from the decision date; (v) the third party's request is on a firm, long-term basis. In this case, the missing capacity, up to 400Mcm/y, will be made available for a period of three years. The Commitment allows the parties to obtain an equivalent quantity in Sinès instead.
787. First, all these conditions make it very questionable whether a third party can actually have access to this additional capacity within a timeframe which makes economic sense. In particular, the third party will have not to be able to import gas for two years before it can request additional capacity to Transgás.
788. Secondly, these conditions exclude providing capacities for short-term imports. Therefore it does not allow imports into Portugal of quantities of gas which would happen to be available in Spain.
789. Thirdly, the third party's request has to be binding, firm and on a long-term basis. However, if the third party finally manages to obtain additional capacity in the pipeline for these long-term needs, this capacity will be offered only for a period of three years. This appears to be far too short for long-term import needs (long-term gas contracts have typically a duration of 10 to 20 years).
790. Fourthly, irrespective of the above, this commitment may not increase the capacity globally available for third parties to import gas into Portugal since the parties have the possibility to compensate for this additional capacity given to third parties by decreasing the capacity available for third parties in the Sinès LNG terminal. Furthermore, since the [300-350]*mcm/y capacity is not warranted in the Extremadura pipeline, the proposed 400mcm/y may actually be the maximum quantity

⁴⁵² Paragraph 17 of the 28.10.2004 draft commitments.

of gas which may be imported into Portugal. Such quantity has been clearly considered by the market test as far from sufficient.

791. Lastly, the parties mention the term “gas release program” to cover the possibility of making this additional capacity available by making the equivalent volume of gas available at the Portuguese border. But the remedy leaves at the parties’ discretion whether capacity or gas will be released further to a request. These two solutions are far from being equivalent from a strategic point of view and the parties may have the ability to use one or the other to the disadvantage of the competitor. If the competitor has already contracted significant amounts of gas, the parties may well opt for the solution they refer to as a " gas release". This would force competitors to buy gas from the parties while they only need free capacity to import theirs.
792. In light of the above, it appears that the modifications included in the latest commitments relating to Campo Maior and the Extremadura pipeline do not solve the main issues raised by the market participants and the Commission further to the previous set of remedies. In particular, the capacity made available in Campo Maior is far too small ([10-20]*% of the capacity in the pipeline); there is no guarantee that competitors will have access to enough capacity in the upstream pipeline (Extremadura) to bring gas up to Campo Maior; the commitment not to book additional capacity is very limited in time as compared with the duration of gas contracts and can be circumvented by the parties by using their Spanish subsidiaries Naturcorp and Union Fenosa Gas.
793. The Commission has come to the conclusion that the parties’ proposal of 17 November 2004 (commitments ENI.II – IX) does not ensure that third parties will be able to import sufficient quantities of natural gas into Portugal in the foreseeable future and hence have very limited, if any, positive effects on the natural gas and electricity markets in Portugal.

Reduction of EDP’s share in REN from 30% to 5% (commitment EDP.1)

794. Further to the first set of remedies, the market test had indicated clearly that, apart from this reduction of EDP’s share in REN, EDP should undertake not to hold any special voting rights, nor to appoint members to the board of REN.
795. Such commitments are not provided for in the 17 November 2004 remedy package. EDP only undertakes⁴⁵³ not to designate members to REN’s board, nor to exercise voting rights until the 25% share in REN has been divested.

Conclusion on commitments relating to infrastructures and transport rights (ENI.II-IX, EDP.1)

796. In the light of all the elements described above relating to commitments ENI.II – IX and EDP.1, the Commission has therefore come to the conclusion that, even though the transfer of these infrastructures and of some transports rights to REN is a positive commitment, numerous issues remain which do not ensure that these commitments will actually be effective and allow a timely entry of sufficient volumes of gas by competitors. The Commission is therefore of the opinion that these commitments would have very limited, if any, pro-competitive effects on the natural gas and electricity markets in Portugal.

⁴⁵³ Schedule I of the EDP commitments.

EDP's ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry.

797. Given (i) the Commission's above-mentioned conclusion on the sale of infrastructures and capacity rights and (ii) that the parties have not provided additional remedies to address this issue, the Commission reaches the same conclusion as the one based on the 28 October 2004 commitments. The Commission considers that, despite the 17 November 2004 remedies, EDP will have ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry. As a result, EDP's dominant position on the electricity wholesale market will be further strengthened.

EDP's ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs

798. Given (i) the Commission's above-mentioned conclusion on the sale of infrastructures and capacity rights and (ii) that the parties have not provided additional remedies to address this issue, the Commission reaches the same conclusion as the one based on the 28 October 2004 commitments. The Commission considers that, despite the 17 November 2004 remedies, EDP will have ability and incentive to manage the constraints in the gas supply to CCGTs to the detriment of actual and potential competing CCGTs.

EDP's access to proprietary information about its competitors' costs and daily gas nominations, conferring on it a significant advantage

799. The commitments proposed by the parties rely exclusively on implementing "Chinese Walls". The market test of the 28 October 2004 commitments has clearly underlined that such measure is inadequate in the present case to prevent the transfer of information between GDP and EDP with a sufficient degree of certainty.

800. Therefore, the Commission considers that, despite the 17 November 2004 remedies, EDP will have the ability to have access to proprietary information about its competitors' costs and daily gas nominations, thereby strengthening further its dominant position on the market.

Conclusion

801. For the reasons mentioned above (paragraphs 768 to 800), considered either separately or together, the Commission has come to the conclusion that, as a result of the vertical effects of the proposed merger and despite the 17 November 2004 remedies, EDP's dominant position on the electricity wholesale market will be strengthened, as a result of which effective competition will be significantly impeded in a substantial part of the common market.

2. Market for ancillary services

802. No additional or modified remedy has been proposed to address the concerns raised by the Commission in the market for ancillary services.

803. The commitments EDP.2 (sales of EDP's shares in Tejo Energia), EDP.3 (moratorium), EDP.4 (lease of a part of TER), and EDP.5 (suspension of EDP's voting rights in Turbogás) are the only ones to directly relate to electricity generation but, as was explained above, these commitments do not ensure with a sufficient level of

certainty that competitors will build new power generation capacities in Portugal in the near future.

804. In addition, respondents to the market test of the first set of remedies have underlined that the lease of TER, as proposed by the parties, did not allow the lessee to take part in the market for ancillary services. Indeed, this market requires almost real-time adaptation of the plant output to ensure the balancing of the electricity network. This requires operating the plant and is incompatible with the nomination of energy in advance (possibly daily nominations) that is planned in the proposed remedies. Irrespective of the above, the lease of TER may stop before new generation capacities have been built in Portugal, thus leaving EDP uncontested in the market for ancillary services.
805. Thus the remedies of 17 November 2004 do not ensure the entry of new competitors on the market for ancillary services to compensate for the loss of GDP. Thus they do not reduce the strengthening of EDP's dominant position in the market for ancillary services due to the proposed merger.

3. Retail supply of electricity

806. In the retail supply of electricity, the Commission has identified that the merger would (i) remove GDP as a strong competitor and (ii) raise further barriers to entry as new entrants would have to enter both gas and electricity retail markets.
807. As in the 28 October 2004 remedies, the only remedy which relates directly to the retail supply of electricity is commitment ENI.XIII (identical to remedy J in the 28 October 2004 remedy set): "*commitment not to engage in dual offers of natural gas and electricity to retail customers until the natural gas supply to such customer groups is liberalised*". Firstly, the meaning of this remedy is unclear since after the merger, the merged entity will supply customers with both gas and electricity. Secondly, the parties' commitment would only apply for a limited period as it would end as from the legal opening of the gas market.
808. In any case, this remedy (ENI.XIII) does not in itself ensure or significantly foster the appearance of competitors to compensate for the loss of GDP.
809. The Commission nevertheless considered whether other remedies could, indirectly, have a positive impact on the retail electricity market.
810. Firstly, it has been examined whether the divestiture of Setgás may be seen as offering a starting point for the acquirer to sell electricity at the retail level. However, the divestiture of this LDC offers a very limited customer base: Setgás accounts for [10-20]*% of the gas retail customers and [0-10]*% of the gas retail sales in 2003. This customer base is far more reduced than the one on which GDP could have relied to enter the electricity market, absent the merger.
811. Secondly, it was also considered that new electricity retailers might come from new entrants in power generation (wholesale market). However, the investigation carried out by the Commission has shown that the launch of new CCGTs in Portugal before 2008 was very unlikely and that such launch may not even take place between 2008 and 2010. As explained above, the remedies proposed by the parties do not ensure with a sufficient degree of certainty that new CCGTs will be built in this timeframe. The lease of TER, because it is very limited in time and in scope, cannot be relied upon to successfully launch a retail business.

812. Therefore, the remedies do not ensure that new competitors will effectively enter the retail supply of electricity in Portugal in a timely manner so as to compensate for the loss of GDP's future competition. Nor do they address the raising of barriers to entry further to the operation. Consequently, the Commission has come to the conclusion that, despite the proposed remedies, the proposed operation leads to the strengthening of EDP's dominant position in the retail supply of electricity.

B. Natural Gas markets

1. Gas supply to power producers

813. There is no fundamental change in the remedies proposed having specific regard to gas supply to power producers, although comparatively minor changes have been introduced to most of the commitments which will be discussed below.

814. First, as far as TER's and EDP dual fuel plant's short term requirements are concerned, (Commitment ENI.X, restating Commitment G of the first set of remedies), the market test of the first set of remedies has already underlined that the elimination of GDP's right of first refusal does not change EDP's incentives, after the concentration, to buy gas from GDP rather than from independent suppliers. The anticompetitive effect of the concentration will therefore not be eliminated.

815. Secondly, concerning Turbogás' short term requirements, EDP's commitment to suspend certain voting rights in Turbogás and, as a new element, to appoint a "Director Trustee" replacing EDP's board members (Commitment EDP 5, varying commitment P) does not appear sufficient to eliminate the customer foreclosure effect of the proposed concentration.

816. Indeed, EDP will probably maintain a significant influence on Turbogás' decisions, given that: i) EDP would suspend its voting rights only concerning the acquisitions of natural gas and new investments, but would continue to vote on other important issues and would therefore maintain some negotiating power on the choice of the gas supplier; ii) the suspension of the voting rights would only last for a limited time of three years, and iii) EDP reserves the right to issue instructions to the Director Trustee "*when it is necessary to prevent a reduction in value of EDP's shareholding*", which is a clause subject to a considerable margin of interpretation and likely not to be fully countervailed by the Commission's possibility to give orders or instructions to the Director Trustee in order to ensure compliance with the conditions and obligations attached to its decision⁴⁵⁴.

⁴⁵⁴ The Commission would likely find it difficult in practice to closely monitor all of Turbogás' board deliberations and decisions and especially those deliberations that are on a more informal basis and the Director Trustee will probably have a tendency to take EDP's financial interest into account to a high degree, even without explicit EDP instructions, simply by way of prior consultations with EDP. EDP, due to this 'advantage of proximity', is therefore likely to retain a significant influence over how the Director Trustee interprets its role and its obligations. Apart from the Director Trustee's written reports, the implementation of this behavioral remedy would be difficult to monitor without the continued and careful assistance of the other shareholders of Turbogás. These other shareholders (in particular International Power but also Koch Transporttechnik), however, can be expected to have a high interest in keeping good relations with EDP. Reference is on the one hand made to the tolling and share purchase option agreement between International Power and EDP. Koch Transporttechnik on the other hand is likely to be an exiting shareholder following an agreement with International Power to sell its 5% of the shares to International

817. As for the suspension of EDP's voting rights in Turbogás, in addition to the problems already indicated on the effectiveness of this remedy, it is again underlined that there is no claim that this company might have any plans to build a new CCGT in Portugal in the future.
818. Thirdly, regarding the Commitments by EDP and ENI on infrastructure, there are, as outlined, doubts on the full effectiveness of the infrastructure commitments. Anyway, even if such remedies were fully effective, it should be pointed out that these remedies would only very indirectly address the competition problem at stake, as they do not in themselves create new demand by ensuring the building of CCGTs by rival operators. The appreciation of these remedies therefore does not change the finding that the remedy package proposed by the parties is insufficient to remedy the strengthening of a dominant position on the market for the supply of natural gas to power producers.
819. Fourthly, the ability of the proposed lessee of one unit of TER to satisfy its additional short term requirements with third parties (see Commitment EDP 4) has only a very limited effect, as it concerns only one of TER's three units.
820. Fifthly, concerning the sale of EDP's participation in Tejo Energia (Commitment EDP.2 relating to Commitment O), the Commission acknowledges that this would eliminate one of the obstacles to the possible development by this company of a new CCGT project. However, it should be noted that, irrespective of the obstacle represented by EDP's interests, an agreement on the development of a new CCGT has not been reached among the other shareholders of Tejo Energia and there are still many uncertainties in this regard⁴⁵⁵.
821. Sixthly, the moratorium concerning the construction of new CCGTs by EDP (Commitment EDP.3, varying and elaborating on commitment M) is likely to be of no significant value for encouraging new demand competing with EDP, as the moratorium will very probably cease after a very short period due to the triggering of its review clause. The proposed moratorium, under the terms proposed, will therefore provide little, if any, additional incentive to build gas-fired power plants in Portugal and, in the terms proposed by the parties, this measure would not effectively and significantly foster the development of new projects. This is for the reasons explained above.
822. In the light of these considerations, it can thus be concluded that the foreclosure of the existing gas demand as a result of the merger will not be eliminated, nor will it be sufficiently countervailed, by the proposed remedies.

2. Gas supply to LDCs

823. With regard to this market the parties have replaced Commitment J of the first set of commitments by Commitment ENI.XIV, which offers the divestment of the Portuguese LDC Setgás within 18 months (instead of the uncertain divestment of unspecified local gas supply companies at a later date). However, also the new commitment is insufficient to remedy the competition problem created by the proposed operation on this market.

Power (see International Power press release of 4.11.2004; <http://www.ipplc.com/ipplc/media/newsreleases/2004/2004-11-04/>. [...])

⁴⁵⁵ See the agreed minutes of a meeting with International Power of 19.9.2004. It should also be noted that both controlling shareholders of Tejo Energia, International Power and Endesa, have concluded agreements with EDP relating to gas-fired generation capacity in Portugal.

824. As outlined above (see paragraph 726), respondents to the Commission’s market test of the first set of remedies argued that the scope of the divestiture should be at the very least the equivalent of Portgás in terms of volume as well as of customers. The Commission shares this view. The almost complete foreclosure of the market for the supply of natural gas to LDCs cannot be remedied by divesting a company such as Setgás that is much smaller than the company whose combination with GDP’s portfolio of companies creates this foreclosure effect. As shown in the table below, Setgás’ size is less than [...] * of Portgás’ size in terms of sales volume⁴⁵⁶.

Sales of natural gas to LDCs (2003)

Company	Sales Volume 2003 (Mm ³)	% in volume
<u>Portgás</u>	[...]*	[20-30]*% <u></u>
<u>Setgás</u>	[...]*	[0-10]*% <u></u>
Beiragás & Tagusgás	[...]*	[0-10]*% <u></u>

Source: merging parties

825. The table also clarifies that even if the envisaged sale of Beiragás and Tagusgás to Iberdrola were to be taken into account (*quod non*, as this sale is not certain and not proposed as a remedy by the parties), the combined size of the three smallest Portuguese LDCs would remain far below Portgás’ share ([60-70]*% less in terms of sales volume).

826. The divestment of Setgás (Commitment ENI.XIV) thus fails to sufficiently address the competition problem of strengthening of GDP’s dominance on the market for supply of natural gas to LDCs.

827. This appreciation is not altered by taking into consideration the commitments proposed on gas infrastructure discussed above. Apart from the doubts of their effectiveness, it should be noted that these commitments, while having a general potential for facilitating entry, do not eliminate or compensate the foreclosure of LDC’s demand. Furthermore, they cannot actually and significantly facilitate entry into this market as it will be – to a very large extent - foreclosed to competition and as little new demand will arise through new entry due to limited customer switching rates among customers of LDCs.

3. Gas supply to large industrial customers

828. The commitments proposed for remedying the competition problems on the market for supply of natural gas to LICs do not fundamentally differ from the remedies proposed in the first set of commitments. It is therefore appropriate to recall that a substantial number of market participants argued that the first set of commitments did not fully address the competition problem raised by the proposed operation. In particular,

- (i) the prohibition of dual sales as long as not both electricity and gas markets are liberalised for a certain customer group was seen as an evident necessity but in itself insufficient (now commitment ENI.XIII, essentially unchanged as to commitment K) ;

⁴⁵⁶ For the supply of gas to LDC, only the quantity of gas bought by LDCs is relevant and not the number of customers that each LDC supplies in turn.

(ii) the infrastructure measures, to the extent they were seen as (potentially) effective, were found to be insufficient by many market participants (now commitments ENI II-IX, and EDP.1; changes will be discussed below);

(iii) the commitment giving those LICs whose gas contract ends between approval of the proposed concentration and liberalisation the (mere) “possibility” to renew their natural gas supply contracts was also considered insufficient (now commitment ENI.XII, unchanged).

829. By contrast, some market participants suggested that a reduction in GDP’s market share (for example, through multi-annual gas release programmes auctioning significant quantities of gas) was necessary. Such a gas release programme has not been offered by the parties as the conditional and discretionary gas release of up to 400 mcm pursuant to Commitment ENI IX, which will be discussed below, is of an entirely different scope and nature.

830. The lack of effective compensation for the loss of Portgás as a potential supplier to LICs is clearly shown by the following table which demonstrates the much lesser potential of Setgás to compete for sales to LICs. It is obvious that LDCs (or supply companies resulting from their unbundling) are particularly well placed to compete, post-opening of markets, for sales to LICs which are located in their distribution territory particularly if these LICs are supplied not via the high-pressure transmission network but via one of the LDCs’ distribution networks. The table shows that Portgás potential to compete for these customers is by far superior to Setgás’ potential.⁴⁵⁷

Large industrial customers (>2Mcm) supplied through LDCs’ distribution networks

LICs supplied through network of:	Number of customers (metering points)	% of customers (metering points)	Annual consumption in 2003 (Mm ³)	% in volume
<u>Portgás</u>	[...]*	[40-50]*% <u>o</u>	[...]*	[30-40]*% <u>o</u>
<u>Setgás</u>	[...]*	[0-10]*% <u>o</u>	[...]*	[10-20]*% <u>o</u>

Source: the merging parties

831. Besides it needs to be pointed out that such comparison between Portgás’ and Setgás’ potential does not even take into account the additional potential for competition for LICs which would have emanated from EDP even in the absence of its acquisition of Portgás.

832. In the Commission’s view, the measures proposed by the parties relating to gas infrastructure, if they were effective, could generally be expected to have some degree of positive effect regarding potential entry into the supply of LICs in Portugal. The Commission also acknowledges that there is a number of improvements in the second set of proposed remedies compared to the first set, especially as regards the timing of the divestitures and the improvements relating to the interim access codes. However, considerable doubts and uncertainties remain as to the proposed remedies’ sufficient effectiveness. In addition to the more detailed discussion of these doubts and

⁴⁵⁷ Nor is this much lesser suitability of Setgás compensated for by Beiragás and Tagusgás with, together, 7 such customers and an annual consumption of these customers of merely [...] Mm³.

uncertainties above, reference can be made in this context in particular to the following factors:

- (i) the explicit exclusion of the parties' Spanish joint ventures Unión Fenosa Gas and Naturcorp, which could lead to booking of the available capacity before it becomes available to third parties;⁴⁵⁸
- (ii) the uncertainty related to the non-requirement of ERSE's approval of the interim access codes and to the effective starting date of application of the codes which may be too late to give third parties sufficient time for preparing and planning their entry into the Portuguese gas markets;
- (iii) the parties' right to reserve on a long-term basis a high amount of available strategic and above all operating capacity with no clear definition of the capacity that would be available for third parties' reservation of storage capacity and no commitment to use-it-or-lose-it rules for the operational storage capacity reserved for the parties;
- (iv) the reduced effectiveness of the possibility for additional 400 million m³ third party capacity at Campo Maior due to the fact that, firstly, two years have to elapse first without pipeline capacity increase before capacity is granted to third parties and that, secondly, the pipeline capacity may be made available at the expense of LNG terminal capacity, thereby not increasing the total capacity available to third parties;⁴⁵⁹
- (vi) the special rights retained by the parties in regard to the keeping of a minority participation in the company operating the Sinès terminal and concerning the option to build a third LNG storage tank both of which are liable to give the parties extra advantages and to discourage entry.

833. For these reasons considerable doubts and uncertainties remain whether the combined effect of such measures will sufficiently compensate for the loss of EDP as a major potential competitor.⁴⁶⁰ The Commission notes in this context that the market test confirmed that the number of potential entrants into supply of LICs in Portugal is rather small and that therefore the elimination of the one of the best placed potential entrants considerably strengthens GDP's dominant position. Therefore, the measures proposed by the parties will not prevent the strengthening of GDP's dominant position in the market for the supply of natural gas to LICs as a result of the merger.

4. Alternative market definition: large wholesale market

834. In the part of the decision on competitive assessment the Commission has shown that, even if a wider wholesale market (comprising the supply of gas to power producers, LDCs and LICs) were considered, the notified concentration would foreclose a very large part of the challengeable gas demand. In particular, it has been shown that the

⁴⁵⁸ [...] [...]

⁴⁵⁹ It should also be noted that this conditional capacity release (which may in certain unlikely circumstances necessitate some gas release) does not correspond to the gas release programme recommended by market participants in the Commission's market test of the first set of commitments which could have constituted an additional entry incentive.

⁴⁶⁰ In this regard, it should again be pointed out that in the Commission's Notice on remedies is clearly indicated that "*it is the responsibility of the parties to show that the proposed remedies, once implemented, eliminate the creation or strengthening of (...) a dominant position identified by the Commission*" (paragraph 6).

foreclosure demand would have consisted of the short term requirements of EDP's gas fired power plants and Turbogás and by the gas consumption of EDP's cogenerator.

835. In this regard, it can be underlined that, as already explained for both the first set of remedies and the second remedy proposal, the proposed remedies are not sufficient to eliminate the foreclosure of EDP's gas fired power plants' and Turbogás' demand, nor the foreclosure of LDCs' demand. In addition, no remedy has been proposed to eliminate the foreclosure of EDP's cogenerator and, as shown, the parties will strengthen their dominance in the area of supplied to LICs. Therefore the proposed remedies are also insufficient to eliminate concerns on a, hypothetical, large 'wholesale' market.

5. Gas supply to small customers

836. It is recalled that the first set of remedies proposed by the parties was found to be clearly insufficient by market participants responding to the Commission's market test in regard to the competition problems created by the proposed concentration on the market for the supply of gas to small customers. Market participants found that the remedies fail to compensate for the very significant loss of GDP as a potential competitor. The following reasons stated by market participants are equally applicable to the second set of proposed remedies:

(i) The (moderate) reduction of market share proposed⁴⁶¹ does not fully compensate for the loss of Portgás as a potential competitor and for the additional potential competition that, even absent its acquisition of joint control in Portgás, would have exerted by EDP;

(ii) The commitment not to offer dual fuel supplies to customers who are not yet liberalised was found to be obviously necessary but clearly insufficient.

837. Market participants suggested that LDC divestments going beyond Portgás divestment were necessary or that a gas release programme, which is designed to encourage and facilitate entry and which might follow the Spanish model at the time of the beginning of the opening of the Spanish market to competition, was necessary.

838. The Commission shares the above concerns expressed by third parties which are valid also for the second set of commitments. The Commission furthermore wishes to reiterate the following considerations:

(i) The result of the market test again made it clear that EDP is one of very few potential entrants and is indeed the most credible and best-placed potential entrant in this market (or, if a regional market definition were retained, in these markets). This underlines the need for forceful remedies in order to protect Portuguese consumers from the harmful effects the proposed concentration would otherwise have on them;

(ii) The remedies proposed by the parties fail to sufficiently address the necessary compensation for the elimination of EDP as a potential competitor also because they ignore circumstances that make EDP such a well placed potential entrant, in particular EDP's access to a large customer base and EDP's brand strength with Portuguese customers.

⁴⁶¹ As noted above, for the second set of commitments the reduction of market share would have been limited to [10-20]% in terms of customers and [0-10] % in terms of volume which, even if considered together with the possible divestment of Beiragás and Tagusgás, would not compensate Portgás' market share.

839. Regarding the infrastructure commitments, it should be noted that available entry capacity is not a sufficient element to successfully enter the market for gas supply to small customers. Furthermore, as indicated above, there are doubts on the full effectiveness of the infrastructure commitments. Also for this reason, they do not sufficiently encourage entry into the supply of small customers with natural gas in Portugal so as to compensate for the loss of EDP as the best placed potential competitor with these customers.
840. If an alternative definition were to be considered for the geographic scope of this market (that is, local instead of national), the divestiture of Setgás would clearly fall short of solving the Commission's competition concerns arising in the other distribution areas (such as Lusitaniagás).
841. The proposed remedies are therefore insufficient to eliminate the competition concern about the strengthening of GDP's dominant position on the market for the supply of gas to small customers.

X. REMEDIES SUBMITTED BY THE PARTIES ON 26 NOVEMBER 2004

842. After the expiration of the deadline set for the submission of remedies⁴⁶², on 26 November 2004, the parties submitted two documents amending (or committing to amend) the remedies already presented, with a view to addressing the concerns raised by the Commission. These commitments are summarised below, distinguishing – as the parties did – between the electricity and gas commitments.

A. Description of the 26.11.2004 remedies

1. Electricity commitments

Reduction of EDP's shares in REN

843. In addition to the previous commitments to reduce EDP's share in REN from 30% to 5%, EDP confirms that it will not have any special rights attached to that 5% stake in REN.

Divestment of Tejo Energia

844. EDP commits to make the divestiture of Tejo Energia unconditional. In particular, a sale at no minimum price will be provided for.

Moratorium concerning the construction of new CCGTs

845. EDP commits not to construct new CCGTs in Portugal (apart from the third group of TER), from the decision date until 30 June 2010. This moratorium can be brought to an end as soon as one year has elapsed after three additional CCGT groups controlled by at least two entities independent from EDP have received the adequate licences from DGGE.

Lease of TER units

846. EDP commits to lease generation capacity at TER equivalent to one unit of TER (392MW) from three to nine months after the decision date until 30.06.2010.

⁴⁶² The deadline for the submission of remedies was 17.11.2004.

847. EDP commits to lease generation capacity at TER equivalent to a second unit of TER (392MW) from 30 March 2006 until 30 June 2010. This second lease will be delayed (i) as long as the building of EDP's third unit is delayed or (ii) the capacity being leased (784MW) exceeds 50% of the thermal capacity of production in Portugal available to be sold in the market, disregarding the production acquired by the single buyer.
848. EDP undertakes to lease generation capacity at TER equivalent to a third unit of TER (392MW) if EDP exercises its option to acquire an additional 20% share in Turbogás and the whole of Turbogás' generation.

2. Gas commitments

849. As far as the gas commitments are concerned, it is important to stress that the parties only indicate that they will amend their previous commitments in the light of some remarks informally made by the Commission, without presenting a final text thereof.

Gas infrastructure

850. The parties commit to amend the commitments II, VII, VIII and IX by specifying that, upon the start of liberalisation and until 31 December 2010, the aggregate capacity committed by the parties, GDP and jointly or solely controlled subsidiaries (including Unión Fenosa Gas or Naturcorp): (i) in Sinès shall not exceed the capacity strictly necessary for the LNG volume of the existing import contracts of GDP and its controlled companies⁴⁶³ and (ii) in the import pipeline shall result in having capacity of 0.9 bcm available for competitors for commitments on a firm long-term basis. If a release of gas were needed in order to allow third parties to have 0.9 bcm available at Campo Maior, the parties agree not to apply any handling fee and, therefore, to apply a price equivalent to the Sonatrach import cost CIF at the Portuguese border (that is, the gas purchase price and related transport costs).
851. As to the Carriço underground storage, the parties undertake to amend commitment III by waiving any reserved right over the operating storage capacity.
852. The parties also indicate that they might undertake that the provisional access codes for access to gas infrastructures would be implemented, as from 1 July 2005, subject to incorporation therein of any comment received meanwhile on the part of ERSE.

LDCs

853. The parties commit to fully divest both Setgás and Lusitaniagás.

Early termination of the gas supply contracts

854. The parties indicate that they will amend commitment XII, in order to allow all their customers except power producers to early terminate their gas supply contract by means of an advanced notice (of three months if the duration of the contract does not exceed one year and of six months in case of contracts exceeding this time) and in two phases.

B. Assessment of the 26.11.2004 remedies

⁴⁶³ In an explanatory note, ENI calculates the capacity needed for these contracts considering that its usage factor (depending on the flexibility required by the market) is in the range between [...] and [...].

855. In determining whether the 26 November 2004 remedies proposed by the parties can be validly taken into consideration by the Commission, account must be taken of the requirements set out in the Commission Regulation (EC) No 447/98 of 1 March 1998 on the notifications, time limits and hearings provided for in Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings⁴⁶⁴ (“the Implementing Regulation”) and in the Commission Notice on remedies acceptable under Council Regulation (EEC) No 4364/89 and under Commission Regulation (EC) No 447/98⁴⁶⁵ (the “Commission Notice”), which apply to such post-deadline undertakings.
856. Article 18(2) of the Implementing Regulation provides that commitments intended by the parties to form the basis of a decision of compatibility pursuant to Article 8(2) of the Merger Regulation are to be submitted to the Commission within not more than three months from the date on which proceedings were initiated, although the Commission may, in exceptional circumstances, extend that period.
857. In the present case, the last day for submitting commitments was 17 November 2004. The latest set of commitments was presented by the parties on 26 November, - which is the day of the Advisory Committee’s meeting - more than a week after the deadline laid down in the Implementing Regulation. Although Article 18(2) of that Regulation provides that the Commission may in exceptional circumstances extend the deadline, the parties did not, before the deadline, ask for such an extension or explain the exceptional circumstances which might justify it. In the Commission’s view, there was nothing in the new proposal which the parties could not have included in an undertaking submitted within the three-month time limit.
858. Besides, paragraph 43 of the Commission Notice indicates that where the parties subsequently modify the proposed commitments, the Commission may only accept them where (i) it can clearly determine – on the basis of its assessment of information already received in the course of the investigation, including the results of prior market testing, and without the need for any other market test – that such commitments, once implemented, resolve the competition problems identified and (ii) there is sufficient time for proper consultation of Member States.
859. Accordingly, the Commission has examined whether, without the need of further market test, it can be concluded that the late remedies submitted by the parties address fully and unambiguously - that is, in a straightforward manner - the competition concerns identified during the investigation.

1. Electricity markets

Wholesale electricity market – horizontal effects

860. In its commitments submitted on 26 November 2004, EDP still proposes to address the Commission’s concerns deriving from the horizontal effects of the operation on the wholesale electricity market through a moratorium, a lease of TER, a divestiture of its 10% share in Tejo Energia, and a suspension of some of its voting rights in Turbogás.
861. With respect to Turbogás, the 17 November 2004 undertakings have not been modified and the analysis made by the Commission in this respect thus remains the same.

⁴⁶⁴ OJ L 61, 2.3.1998, p. 1; Regulation as amended by the 2003 Act of Accession.

⁴⁶⁵ OJ C 68, 2.3.2001, p. 3.

862. As regards the moratorium on the construction of new CCGTs, the latest proposal submitted by EDP is still far from ensuring that new companies will effectively enter the Portuguese market before EDP is allowed to build a new gas-fired power plant. Indeed, under the new wording proposed by EDP, the moratorium could come to an end one year after licences have been delivered to three additional CCGT units controlled by two entities independent from EDP. Although this new proposal now refers to three rather than two additional CCGT units, the problem remains that this commitment would not ensure that competing CCGTs are actually operational on the market. As already explained at length in the sections above (see paragraph 745 to 749), the construction of a CCGT unit may not take place at all following the issue of a licence and, in any event, may take several years before it becomes operational on the market. Besides, the question arises as to whether the wording effectively prevents the other party to the merger, ENI, from applying for a license, either directly or through a subsidiary. In addition, such a moratorium would come to an end in June 2010 in any event, that is to say, even if no other competitor has actually entered the Portuguese market. Finally, it must also be underlined that EDP would not be prevented from building its third TER unit.
863. As concerns the lease of TER, EDP undertakes to lease the capacity equivalent to three units of TER until 2010, but under several conditions which, in fact, would allow the parties to actually limit this lease to only one unit and which in any event would, most probably, not lead to a lease of the three TER units during the same period.
864. Thus, according to EDP's commitment, the lease of the second unit of TER (which has become operational very recently) would only start in 2006 at the earliest and would be postponed if the starting of TER's third unit is postponed or if the capacity being leased exceeds 50% of the thermal capacity of production in Portugal which is not acquired by the single buyer. As a result of the latter condition, the lease of TER's second unit would not take place as long as a major part of the PPAs has not been terminated. Given that EDP has in principle the ability to oppose the termination of both its PPAs⁴⁶⁶ (which account for the major part) [...]⁴⁶⁷, EDP would therefore have the ability to prevent, or at least considerably delay, the lease of the second unit of TER. Similarly, with respect to the lease of the third unit of TER, it would not take place as long as EDP has not exercised its option to acquire Turbogás' production and shares and this exercise has been cleared by the relevant competition authority. Not only EDP could decide not to exercise this option, thus preventing the lease of the third unit, but also such exercise could well be prevented by the national competition authority given EDP's position on the market. In any event, under the relevant contractual provisions EDP would be in a position to exercise such option [...]*, whereas the lease would necessarily fall in 2010. As a result, the lease of the third unit would only last for [...]*.
865. It must also be underlined that the commitment provides that the lease of each unit would end as soon as an independent operator starts operating a similar unit. Consequently, it is far from certain, and indeed unlikely, that the full capacity of TER would ever be leased at the same time. In any event, the lease would end in 2010 even in the absence of any entry on the Portuguese market.

⁴⁶⁶ PPAs are contracts between two parties and therefore require the agreement of both parties (e.g. EDP and REN) to be terminated.

⁴⁶⁷ [...]

866. Besides, other important uncertainties remain in the wording of the commitment submitted by EDP. In particular, the Commission notes that the selection criteria of the lessee do not ensure that it would develop as an effective competitive force on the market since the selection of the lessee would not be dependent on the absence of any structural or contractual links with the parties. Similarly, any lessee would remain highly dependent on EDP since the latter would keep operating TER and would know the daily quantities to be marketed by the lessee.
867. Finally, with respect to the sale of its 10% shareholding in Tejo Energia, the Commission welcomes the fact that EDP's commitment no longer makes it conditional upon the obtention of a price corresponding to fair market value. However, such limited commitment is obviously far from sufficient to address the Commission's concerns.
868. It follows from all the elements mentioned above that, despite EDP's more clear-cut proposal with respect to the sale of its 10% share in Tejo Energia, the parties' late commitments fall short of addressing the competition concerns resulting from the horizontal effects of the transaction on the wholesale electricity market. In particular, it is far from certain that the proposed lease and moratorium would have an effect equivalent to that of a structural remedy allowing for effective and timely entry into the market.

Wholesale electricity market – vertical effects of the merger

869. As regards EDP's privileged and preferential access to the Portuguese gas infrastructure, the document submitted on 26 November 2004 by the parties contains only intentions to modify the previous commitments in a certain way, without actually submitting a detailed drafting of such amended commitments. To the extent that such intentions do not amount to formal commitments and that the deadline for the submission of remedies has elapsed, the Commission considers that for these reasons alone this proposal could not be validly taken into account.
870. However, for the sake of completeness, this proposal is assessed below. In this context, grave uncertainties still remain as to the effectiveness of such intentions depending on the wording finally retained.
871. Irrespective of uncertainties due to the ultimate wording, some of the parties' stated intentions either do not address a number of the shortcomings already identified in the 28 October and 17 November remedies or even go below previous commitments. For instance, with respect to ensuring sufficient available capacity to import gas via the Spain/Portugal pipeline, there are high uncertainties as to the technicalities with which the parties foresee to ensure sufficient access capacity in the import pipeline. In this regard, it should be noted that the parties state in their 26 November document that "*the parties believe that the proposed commitment IX [ENI.IX] already satisfies the Commission's request*"⁴⁶⁸ and do not provide for any clear additional commitment relating to the access of the import pipeline.
872. With respect to the Sinès LNG terminal, an explanatory note attached to the 26 November remedy package specifies that the capacity necessary for the parties is not of [...] bcm/y, as stated all along the procedure, but of [...] bcm/y given that "*the required usage factor, which will depend on the flexibility required by the market, is in*

⁴⁶⁸ Document submitted by ENI on 26.11.2004.

*the range of [...]**⁴⁶⁹. As a result, depending on the usage factor of the parties, the parties' imports due to their existing contracts will limit the quantity of gas which can actually be imported and sold to customers by competitors on equal terms with the merging parties via Sinès to levels ranging from less than [...]* bcm (usage factor of [...]*) to [...]* bcm (usage factor of [...]*). This turns out to be far below what has been stated by the parties so far and served as an explicit basis to the market test.

873. The elements provided by the parties therefore do not ensure in the straightforward way which is required at this stage of the procedure that sufficient capacity will be available for third parties to import gas into Portugal. As a result, the Commission's concerns remain as to EDP's privileged and preferential access to the Portuguese gas infrastructure and the strengthening of EDP's dominant position which derive therefrom.

874. The commitments submitted on 26 November 2004 do not provide for any additional clear remedy as regards any of the following specific vertical competition concerns arising in the electricity wholesale market:

- EDP's ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry;
- EDP's ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs;
- EDP's access to proprietary information about its competitors' costs and daily gas nominations, conferring on it a significant advantage.

875. The analysis previously made by the Commission in these respects thus remains unaltered.

Market for ancillary services – loss of potential competition

876. Like the previous sets of commitments, the 26 November 2004 package does not provide for any separate remedy addressing the concerns raised with respect to this market. In particular, as explained above, the commitments do not provide that the lessee will be allowed to adapt in realtime the output of the power plant. Therefore it is far from certain that the lessee will be able to be active in the market for ancillary services in Portugal.

Retail electricity market – loss of potential competition

877. Like the previous sets of commitments, the 26 November 2004 package does not provide for any remedy addressing directly the loss of competition in the retail electricity market.

878. As in the previous sets of remedies, only indirect impacts could be extrapolated: competition coming (i) from the gas LDCs which are proposed to be divested or (ii) from new power generation players.

879. In the document submitted on 26 November 2004, ENI states that it intends to modify its previous commitments to provide for the divestiture of both Setgás and Lusitaniagás (instead of Setgás alone). The same reservations as underlined above apply as to the actual terms and conditions which will be attached to the divestiture. However, irrespective of the latter, Setgás/Lusitaniagás account for only [30-40]*% of GDP's

⁴⁶⁹ Explanatory note to the memorandum to the European Commission of 26 November.

customer base and the commitments do not impose that the acquirer of these companies has intentions to enter the electricity retail market.

880. Similarly, the commitments do not guarantee that new competitors will enter power generation in Portugal. The proposed lease is far too short to enable the lessee(s) to develop a long-term and successful electricity retail business. Besides, there is no requirement for the lessee to have plans to develop electricity retail activities. It is also recalled that the commitments do not formally exclude the possibility for the lessee to have links with the parties.
881. Therefore, the 26 November 2004 remedies do not satisfactorily address the competition concerns resulting from the strengthening of EDP's dominant position in the electricity retail market in Portugal.

2. Gas markets

882. As indicated above, with respect to the gas commitments, the parties only stated that they will amend their previous commitments in light of some remarks informally made by the Commission, without actually submitting a detailed drafting of such amended commitments. To the extent that such intentions do not amount to formal commitments and that the deadline for the submission of remedies has elapsed, the Commission considers that for these reasons alone this proposal could not be validly taken into account. However, for the sake of completeness, this proposal is assessed below.

Gas supply to power producers

883. No major changes have been introduced by the parties as regards the market for gas supply to power producers.
884. As far as the foreclosure of Turbogás' short term requirements is concerned, no new remedies have been presented by the parties. In this respect, the Commission's analysis relating to the evaluation of the previous commitments thus remains unaltered.
885. Concerning the foreclosure of TER's short term requirements, the parties have made some change on the scope of the proposed lease. However, as indicated above, the amendments presented by the parties do not guarantee that the lease will effectively concern all three units of TER and will therefore fully eliminate the foreclosure effect of the merger. The limited duration of the lease and the conditions which trigger its suspension can also significantly reduce its effects.
886. In addition, the amendments presented by the parties do not guarantee that the foreclosure effect of the merger is compensated by the creation of new gas demand.
887. In this regard, it must first be recalled that no clear commitments have been presented concerning gas infrastructures, but only general intentions on future amendments to the commitments already presented. In this situation the Commission is not able to evaluate whether these amendments, in their current wording, would ensure effective third-party access to gas infrastructures. In any event, as already indicated, even if such commitments were fully effective, they would only very indirectly address the competition problem at stake and are not sufficient to remedy the strengthening of a dominant position on the market for the supply of natural gas to power producers. It is furthermore recalled that ENI's explanatory note attached to the 26 November 2004 remedies does not exclude the possibility (at a usage factor of [...]*) for both parties and third parties) that less than [...] bcm of gas could be supplied through the Sinès LNG terminal by parties' competitors. This would only be sufficient for the supply of two CCGT units.

888. Second, it has already been explained that the proposed moratorium (see above) will not guarantee the entry of competitors and, thus, the creation of new demand.
889. Third, as already explained when analysing the previous commitments, the sale of EDP's minority participation in Tejo Energia is not sufficient to guarantee the construction of a new CCGT.
890. The Commission therefore concludes that the proposed amendments to the commitments presented by the parties are not sufficient to prevent the strengthening of GDP's dominant position on the market for gas supply to power producers.

Gas supply to LDCs

891. With regard to this market, the parties propose to amend commitment ENI.XIV, undertaking to divest Setgás and Lusitaniagás.
892. Considering that the aggregate current consumption of these two LDCs is substantially equivalent to the one of Portgás (see the table below), the Commission believes that, notwithstanding the stronger growth rate of Portgás, this divestiture compensates the foreclosure of Portgás' demand.

Sales of natural gas to LDCs (2003)

Company	Sales Volume 2003 (Mm ³)	% in volume
Setgás	[...]*	[0-10]**%
Lusitaniagás	[...]*	[20-30]**%
Setgás+Lusitaniagás	[...]*	[30-40]**%
Portgás	[...]*	[20-30]**%

Source: merging parties

893. Even in the absence of a specific market test, the Commission can therefore conclude that the remedy, if amended as suggested by the parties, would, with sufficient certainty, prevent the strengthening of GDP's dominant position on the market for gas supply to LDCs.

Gas supply to LICs

894. As far as the market for gas supply to LICs is concerned, three amendments proposed by the parties should be considered: the sale of Setgás and Lusitaniagás, the right of early termination of the gas contracts and the amendments on the gas infrastructure.
895. Regarding the sale of Setgás and Lusitaniagás, the Commission acknowledges that in terms of number of LICs and volume of gas distributed, these two LDCs can be considered as equivalent to or larger than Portgás.

LICs supplied through network of:	Number of customers (metering points)	% of customers (metering points)	Annual consumption in 2003 (Mm ³)	% in volume
Setgás	[...]*	[0-10]*%	[...]*	[10-20]*%
Lusitaniagás	[...]*	[30-40]*%	[...]*	[40-50]*%
Setgás+Lusitaniagás	[...]*	[40-50]*%	[...]*	[50-60]*%
Portgás	[...]*	[40-50]*%	[...]*	[30-40]*%

Source: the merging parties

896. The loss of Portgás as a potential supplier to LICs might therefore be compensated by the sale of these two LDCs. Uncertainties remain as to the aggregate growth rate of Lusitaniagás and Setgás as compared with that of Portgás, which seems to be stronger.
897. However, the question arises as to whether the divestitures of Setgás and Lusitaniagás in itself fully compensate for the loss of potential competition that EDP would have exerted on GDP, thanks to EDP's strong intrinsic competitive advantages other than those obtained through the acquisition of Portgás, in particular due to its brand strength, its very large customer base and its strong incentives to enter this market even in the absence of its acquisition of Portgás (see paragraphs 539 to 550).
898. In this phase of the procedure, given the practical impossibility to conduct a new market test, the Commission is not able to conclude with a sufficient degree of certainty that the loss of EDP's potential competition would be compensated by the pro-competitive effect of the proposed amendments concerning the right of early termination of the existing contracts. This is all the more so as the parties described only in general terms the content of this right, but did not present a clearly-drafted commitment on this aspect.
899. In addition, as explained before, significant uncertainties still remain on the proposed amendments concerning the gas infrastructures. It is therefore not clear that third parties would be able to import gas into Portugal in an effective manner and in sufficient quantities as to compensate for the loss of EDP's potential competition.
900. On the basis of the abovementioned consideration, the Commission is not able to conclude with the degree of certainty required in this late stage of the procedure that the proposed remedies will prevent the strengthening of GDP's dominant position on the market for gas supply to LICs.

Alternative market definition: large wholesale market

901. If a large wholesale market encompassing the supply to both CCGTs, LICs and LDCs is considered, the Commission is not in a position, on the basis of the commitment submitted, to clearly conclude that the remedies, if amended as suggested by the parties, would solve the competition problems arising from the concentration.
902. In particular, it can be underlined that, as already explained, the proposed amendments are not sufficient to eliminate the foreclosure of EDP's gas-fired power plants' and Turbogás' demand. In addition, no remedy has been proposed to eliminate the foreclosure of EDP's cogenerator.

903. Even if, as explained, the foreclosure of Portgás' demand will be compensated by the divestiture of Setgás and Lusitaniagás, a large part of the challengeable demand will still be foreclosed because of the merger.
904. The Commission is therefore not able to conclude with the degree of certainty required at this late stage of the procedure that the proposed remedies will prevent the strengthening of GDP's dominant position on a hypothetical large 'wholesale' market.

Gas supply to small customers

905. Regarding the market for gas supply to small customers, three amendments proposed by the parties should be considered: the sale of Setgás and Lusitaniagás, the right of early termination of the gas contracts and the amendments on the gas infrastructure.
906. On the first amendment, it should be underlined that, as already explained with regard to the supply of LICs, in terms of number of customers and volume of sales Setgás and Lusitaniagás can be considered equivalent to Portgás. The loss of Portgás' competition might therefore be compensated by the sale of these two LCDs.
907. However, as for the supply of LICs, the divestiture of Setgás and Lusitaniagás does not appear in itself sufficient to compensate for the loss of potential competition that EDP would have exerted on GDP, thanks to EDP's strong intrinsic competitive advantages other than those obtained through the acquisition of Portgás, in particular due to its brand strength, its very large customer base and its strong incentives to enter this market even in the absence of its acquisition of Portgás (see paragraphs 559 to 602).
908. Also in this case, it is not possible to clearly conclude that the loss of EDP's potential competition would be compensated by the pro-competitive effect of the proposed amendments concerning the right of early termination of the existing contracts. This is all the more so as the parties merely announced in general terms the content of this right, but did not present a clearly drafted commitment on this aspect.
909. Furthermore, as explained before, significant uncertainties still remain on the proposed amendments concerning the gas infrastructures. It is therefore not clear that third parties would be able to import gas into Portugal in an effective manner and in sufficient quantities as to compensate for the loss of EDP's potential competition.
910. If an alternative definition were to be considered for the geographic scope of this market (that is to say, regional instead of national), the question arises as to whether the divestiture of Setgás and Lusitaniagás would clearly solve the Commission's competition concerns arising in other distribution areas.
911. On the basis of the abovementioned consideration, the Commission is not able to conclude with the degree of certainty required in this late stage of the procedure that the proposed remedies will prevent the strengthening of GDP's dominant position on the market for gas supply to small customers.

3. Conclusion

912. It follows from the above that the 26 November 2004 remedies, submitted after the deadline, do not fully and unambiguously remove the competition concerns identified

by the Commission. As a consequence, such proposals cannot be validly taken into consideration⁴⁷⁰ and in any event cannot form the basis of an authorisation decision.

XI. REMEDIES SUBMITTED BY THE PARTIES ON 3 DECEMBER 2004

913. On Friday evening 3 December 2004 (well after “close of business”), the parties submitted, without previously alerting the Commission, a new set of “gas commitments” aiming to implement the intentions stated by them in the document sent to the Commission on 26 November 2004 (see above, paragraphs 849-854). Considering the very late stage of the procedure at which these new commitments have been presented (only three working days before the Commission meeting of 9 December 2004 scheduled for the adoption of the final decision⁴⁷¹, leaving insufficient time for the Commission to assess them in accordance with procedural obligations) and given that this proposal merely aims to implement the intentions expressed in the document sent on 26 November 2004 (for the considerations in relation to these intentions, see above, paragraphs 855-911), this latest set of commitments cannot form the basis of an authorisation decision.

XII. CONCLUSION

914. For the reasons mentioned above, whether considered individually or together, the Commission has come to the conclusion that, despite the commitments proposed by the parties, the proposed operation will strengthen EDP’s dominant position on the markets for the wholesale supply of electricity, ancillary services and retail supply of electricity in Portugal as well as GDP’s dominant position in the supply of gas to CCGTs, LDCs, LICs and small customers, as a result of which effective competition will be significantly impeded in a substantial part of the common market, within the meaning of Article 2(3) of the Merger Regulation. The proposed merger must therefore be declared incompatible with the common market pursuant to Article 8(3) of the Merger Regulation.

HAS ADOPTED THE DECISION

Article 1

The concentration by which Energias de Portugal SA and ENI Portugal Investment S.p.A. acquire joint control over Gás de Portugal SGPS S.A. is declared incompatible with the common market.

⁴⁷⁰ See judgment of 3 April 2003, in case T-119/02 *Royal Philips v. Commission*, [2003] ECR II-1433, at point 235 and Commission Decision of 14 March 2000 in Case M.1672-Volvo/Scania, (OJ L 143, 29.5.2001, p. 74) at points 359-361.

⁴⁷¹ The draft final decision in merger cases are normally to be submitted to the penultimate Commission meeting before the expiry of the deadline laid down in Article 10(3) of the Merger Regulation, in order to allow the College to decide on an amended text should a majority of its members object to the first draft. In the present case the deadline laid down in Article 10(3) of the Regulation is 15 December 2004 and the penultimate Commission meeting before the expiry of this deadline is that of 9 December 2004.

Article 2

This Decision is addressed to:

EDP – Energias de Portugal, SA
Praça Marquês de Pombal 12
1250-162 Lisboa
Portugal

ENI S.p.A.
Piazzale Enrico Mattei 1
I-00144 Roma
Italy

Done at Brussels, 09.12.2004

For the Commission
*Neelie **KROES***
Member of the Commission

Article 8.3 Decision

TABLE OF CONTENTS

<u>I.</u>	<u>THE PARTIES</u>	3
<u>II.</u>	<u>THE OPERATION AND THE CONCENTRATION</u>	3
<u>III.</u>	<u>COMMUNITY DIMENSION</u>	4
<u>IV.</u>	<u>RELEVANT MARKETS</u>	4
<u>A.</u>	<u>Relevant markets in the energy sector</u>	4
<u>B.</u>	<u>The relevant electricity markets</u>	5
1.	<u>Regulatory framework</u>	5
(a)	<u>Current legal framework</u>	5
(b)	<u>Amendments to the existing regulatory framework</u>	6
(c)	<u>The Iberian electricity market (MIBEL)</u>	7
2.	<u>Electricity product markets</u>	7
(a)	<u>General</u>	7
(b)	<u>Transmission and distribution grids</u>	8
(c)	<u>Wholesale of electricity</u>	8
(d)	<u>Balancing power and ancillary services</u>	11
(e)	<u>Retail supply of electricity</u>	11
	<u>Description of electricity retail in Portugal</u>	11
	<u>The relevant product markets in electricity retail</u>	12
3.	<u>Geographical markets in electricity</u>	15
(a)	<u>Transmission and distribution grids</u>	15
(b)	<u>Wholesale of electricity</u>	15
	<u>Currently, Portugal clearly constitutes a distinct geographic market</u>	16
	<u>The current level of interconnections between Spain and Portugal is not sufficient to consider the existence of a single market in the Iberian peninsula</u>	16
	<u>The termination of the PPAs will not change the import/congestion levels</u>	19
	<u>Price differentials between Spain and Portugal</u>	20
	<u>It is highly unlikely that the wholesale electricity market will effectively be Iberian in scope in the near future</u>	21
	<u>Many important regulatory barriers have still to be removed for the purpose of the establishment of the MIBEL</u>	22
	<u>The projected level of interconnection capacity between Spain and Portugal is not likely to allow effective integration of both markets in the near future</u>	28
	<u>Generation mixes in Spain and in Portugal are different and will remain so</u>	30
	<u>Third parties' estimates of necessary interconnections are well above expected levels in 2008</u>	31
	<u>Discussion on forecasts submitted by the parties</u>	33
	<u>EDP as the main electricity generator in Portugal has the ability to artificially reduce the interconnection level available for competitors</u>	34
	<u>Frequent congestions create different competition conditions between Spain and Portugal on a permanent basis</u>	35
	<u>Conclusion on the geographic dimension of the wholesale electricity market on the basis of abovementioned elements</u>	37
	<u>Competitive conditions between Spain and Portugal are likely to remain significantly different even after the launch of the MIBEL</u>	37

<u>CO2 emission national allocation plans (NAP) may have significant and different impacts on the national merit orders</u>	37
<u>Compensation scheme will have a significant impact on prices</u>	38
<u>Even though compensation schemes are similar in principles, their implementation leads to strong differences in the pricing behaviours in each country</u>	39
<u>Parties' position in their replies to the statement of objections</u>	41
<u>Conclusion</u>	41
(c) <u>Ancillary services</u>	41
(d) <u>Retail markets</u>	42
C. <u>Relevant Natural Gas markets</u>	43
1. <u>The legal and factual framework</u>	43
(a) <u>Description of the current situation of natural gas supply in Portugal</u>	43
<u>The Maghreb international pipeline</u>	43
<u>The Sinès LNG terminal</u>	44
<u>Distribution and supply</u>	44
(b) <u>The opening of the natural gas sector</u>	46
2. <u>Product markets in Natural Gas</u>	47
(a) <u>The parties' view</u>	47
(b) <u>The assessment of the impact of the concentration on markets not yet open to competition</u>	48
(c) <u>Commission's view on the different product markets</u>	48
<u>Parties' and competitors' perceptions</u>	49
<u>Shell - Spain</u>	49
<u>GdF- Spain</u>	49
<u>Gas Natural</u>	50
<u>EDF</u>	50
<u>Iberdrola</u>	50
<u>Different supply needs and consumption patterns</u>	51
<u>Different type, duration and flexibility provisions of contracts</u>	53
<u>Margins are different</u>	54
<u>Customer relationships are different</u>	55
<u>The commercial needs of resellers are different</u>	56
<u>Growth dynamics are different</u>	56
<u>Arbitrage and supply side substitutability are insufficient</u>	57
<u>ENI's general remarks on market definition</u>	61
<u>Conclusion</u>	62
3. <u>Geographic markets in Natural Gas</u>	62
V. <u>COMPETITIVE ASSESSMENT</u>	64
A. <u>Electricity markets</u>	64
1. <u>Wholesale of electricity</u>	64
(a) <u>EDP holds a dominant position on the wholesale market for electricity in Portugal</u>	64
<u>EDP holds 70% of generation capacity, accounts for 70% of generation and is the largest importer of electricity</u>	64
<u>EDP's Portuguese generation portfolio will remain unmatched</u>	66
<u>The CMEC compensation scheme favours incumbents</u>	66
<u>EDP Distribuição's role as regulated retailer strengthens EDP</u>	67
<u>The addition of TER is significant in EDP's portfolio</u>	68
<u>Competitors' projects are highly uncertain and EDP has significant influence over one of them</u>	69
<u>Capacity agreements with competitors risk having a stifling impact on competitive market behaviour</u>	71
<u>Demand will grow but it is very uncertain whether this will lead to the building of three new CCGTs before 2010</u>	72
<u>Imports will remain insufficient to challenge EDP's dominance</u>	73
(b) <u>EDP's dominant position will be strengthened as a result of the merger because of horizontal and non-horizontal effects</u>	73
b.1) <u>Horizontal effects: removal of a significant potential competitor</u>	73
<u>Prior to the merger, there were strong incentives for GALP/GDP to enter the wholesale electricity market and to develop as EDP's main competitor</u>	74

<u>Respondents' views confirm this strong incentive</u>	74
<u>Strong economic rationale for entry</u>	74
<u>Rationale for entry in wholesale is aligned with rationale for entry in retail</u>	75
<u>It is very likely that, absent the merger, GALP/GDP would have successfully entered the wholesale electricity market</u>	75
<u>GALP Power's activities prove an interest in electricity</u>	75
<u>Conclusion on GDP incentives to enter and plans of entry</u>	77
<u>b.2) Non-horizontal effects</u>	77
<u>1. The concentration will give the merged entity access to proprietary information about its competitors</u>	78
<u>Access to gas costs of current competitors</u>	78
<u>Access to gas nominations of current competitors</u>	78
<u>Access to similar information on future competitors</u>	79
<u>Replies to the statement of objections</u>	79
<u>Conclusion on access to proprietary information</u>	80
<u>2. EDP would have privileged and preferential access to natural gas resources available in Portugal</u>	80
<u>GDP's international pipeline</u>	81
<u>GDP's Sinès LNG terminal</u>	83
<u>GDP's Carriço underground storage</u>	85
<u>EDP will enjoy significant advantages in the management of the gas supply</u>	85
<u>3. The merged entity will have the ability and the incentives to raise rivals' input costs</u>	87
<u>The merged entity will have the ability and incentive to raise the price of Turbogás' short-term requirements</u>	87
<u>Future CCGTs, if any, are likely to be supplied by the merged entity</u>	88
<u>EDP will have the ability and incentive to raise the gas costs of competing CCGTs</u>	89
<u>(c) Conclusion</u>	90
<u>2. Market for ancillary services</u>	90
<u>3. Retail supply of electricity</u>	91
<u>(a) EDP holds a dominant position on the retail markets for electricity in Portugal</u>	91
<u>The parties' position in their replies to the statement of objections</u>	92
<u>(b) EDP's dominant positions will be strengthened as a result of the merger</u>	93
<u>The merger will eliminate a significant potential competitor on both markets</u>	93
<u>The parties' position in their replies to the statement of objections</u>	97
<u>Conclusion</u>	98
<u>B. Natural Gas markets</u>.....	99
<u>1. GDP holds a dominant position on the natural gas markets in Portugal</u>	99
<u>GDP's incumbency advantages</u>	100
<u>The limited customer switching rate from the incumbent gas operator</u>	102
<u>Existing entry barriers</u>	103
<u>The level of growth of the Portuguese gas markets after the opening of competition</u>	105
<u>Conclusion</u>	105
<u>2. GDP's dominant position on the Portuguese gas markets will be strengthened as a result of the merger</u>	105
<u>(a) Gas supply to power producers</u>	105
<u>Foreclosure of the existing demand</u>	106
<u>The creation of new demand</u>	108
<u>Conclusion</u>	109
<u>(b) Gas supply to LDCs</u>	109
<u>(c) Gas supply to large industrial customers</u>	110
<u>(d) Alternative market definition: large wholesale market (gas supply to power producers, LDCs and large industrial customers)</u>	112
<u>(e) Gas supply to small customers (small industrial, commercial and household customers)</u>	113
<u>As an electricity incumbent, EDP has strong advantages in entering the market for the supply of gas to small customers; the ownership of an LDC gives it further advantages and proves its ability to enter/expand</u>	114
<u>Advantages in procurement due to CCGTs</u>	115
<u>Advantages as an incumbent electricity retail distributor and supplier</u>	115
<u>Customer contacts and relationships</u>	115
<u>Dual fuel offers</u>	116

<u>Brand strength</u>	117
<u>Advantages due to EDP's position in, and information on gas retailing in Portugal</u>	117
<u>Given its strong incentives, EDP could have been expected to enter/expand in the market</u>	119
<u>EDP's elimination as an immediate and potential competitor would strengthen the dominant position of GDP and raise entry barriers further</u>	120
<u>Conclusion</u>	121
C. <u>Other arguments put forward by the parties</u>	121
D. <u>Conclusion on the competitive assessment of the notified operation</u>	122
<u>VI. DESCRIPTION OF THE REMEDIES PROPOSED BY THE PARTIES ON 28 OCTOBER 2004</u>	123
A. <u>Sale to REN of the Sinès LNG re-gasification terminal</u>	123
B. <u>SALE TO REN OF THE CARRICO UNDERGROUND STORAGE FACILITY</u>	124
C. <u>Guarantees for access to the Network pending publication of the relevant TPA rules</u>	124
D. <u>Release to REN of the capacity at the Campo Maior entry point currently booked and unused by Transgás S.A.</u>	124
E. <u>Commitment not to book further capacity at the Campo Maior entry point</u>	125
F. <u>Commitment not to book further capacity on the Extremadura pipeline</u>	125
G. <u>Elimination of GDP's right of first refusal, based on a "matching the best offer mechanism", provided for in the Shareholders' Agreement with regard to the short-term natural gas requirements of EDP's gas-fired generation plants</u>	126
H. <u>measures aimed at eliminating concerns related to possible privileged access to price information</u> 126	
I. <u>Measures aimed at ensuring scope for the effective liberalisation of the demand represented by large industrial customers ("LICs")</u>	126
J. <u>Commitment to sell to a viable buyer one or more supply companies controlled by gdp or by any of the Parties</u>	126
K. <u>Commitment not to engage in dual offers of natural gas and electricity to LICs and retail customers in Portugal until the natural gas supply to such customer groups is liberalized</u>	127
L. <u>Reduction of EDP's participation in REN from 30% to around 5%</u>	127
M. <u>Moratorium concerning the construction of new CCGTs</u>	127
N. <u>Commitment to implement the lease of TER</u>	127
O. <u>Commitment to sell EDP's participation in Tejo Energia</u>	128
P. <u>Commitment to suspend voting rights and to appoint independent Board Members in Turbogás</u> 129	
<u>VII. ASSESSMENT OF THE REMEDIES PROPOSED BY THE PARTIES ON 28 OCTOBER 2004</u>	129
A. <u>Electricity markets</u>	129
1. <u>Wholesale electricity market</u>	129

(a)	<u>Strengthening of EDP's dominant position as a result of horizontal effects</u>	129
	<u>Moratorium concerning the construction of new CCGTs and capacity lease on TER (commitments M and N)</u>	129
	<u>Commitment to sell EDP's participation in Tejo Energia (commitment O)</u>	132
	<u>Commitment to suspend voting rights and to appoint independent Board Members in Turbogás (commitment P)</u>	133
(b)	<u>Strengthening of EDP's dominant position as a result of non-horizontal effects</u>	133
	<u>EDP's privileged and preferential access to the Portuguese gas infrastructure (commitments A-F, L)</u>	133
	<u>Sinès LNG terminal and access to the network (commitment A)</u>	133
	<u>Carrico underground storage (Commitment B)</u>	135
	<u>Guarantees for Access to the network pending the publication of the relevant TPA rules (Commitment C)</u>	136
	<u>Campo Maior / Extremadura pipeline (Commitments D, E, F)</u>	136
	<u>Reduction of EDP's share in REN (commitment L)</u>	138
	<u>Conclusion on commitments relating to infrastructures and transport rights (A-F, L)</u>	138
	<u>EDP's ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry</u>	138
	<u>EDP's ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs</u>	139
	<u>EDP's access to proprietary information about its competitors' costs, conferring on it a significant advantage</u>	139
	<u>EDP's access to the daily gas nomination of its main competitors, conferring on it a significant advantage</u>	139
2.	<u>Market for ancillary services</u>	140
3.	<u>Retail supply of electricity</u>	140
B.	<u>Natural Gas markets</u>	141
1.	<u>Gas supply to power producers</u>	141
2.	<u>Gas supply to LDCs</u>	142
3.	<u>Gas supply to large industrial customers</u>	143
4.	<u>Alternative market definition: large wholesale market</u>	144
5.	<u>Gas supply to small customers</u>	144
VIII.	<u>DESCRIPTION OF THE SECOND SET OF REMEDIES PROPOSED BY THE PARTIES ON 17 NOVEMBER 2004</u>	145
IX.	<u>ASSESSMENT OF THE SECOND SET OF REMEDIES PROPOSED BY THE PARTIES ON 17 NOVEMBER 2004</u>	146
A.	<u>Electricity markets</u>	146
1.	<u>Wholesale electricity market</u>	146
(a)	<u>Strengthening of EDP's dominant position as a result of horizontal effects</u>	146
	<u>Moratorium concerning the construction of new CCGTs and capacity lease on TER (commitments EDP 3 and 4)</u>	146
	<u>Moratorium</u>	147
	<u>Capacity lease of one unit of TER</u>	148
	<u>Conclusion on the moratorium and the lease proposed EDP</u>	149
	<u>Commitment to sell EDP's participation in Tejo Energia (commitment EDP.2)</u>	149
	<u>Commitment to suspend voting rights and to appoint independent Board Members in Turbogás (commitment EDP.5)</u>	150
	<u>Conclusion as to horizontal effects on the wholesale electricity market</u>	151
(b)	<u>Strengthening of EDP's dominant position as a result of non-horizontal effects</u>	151
	<u>EDP's privileged and preferential access to the Portuguese gas infrastructure (commitments ENI.II – IX, EDP.1)</u>	151
	<u>Sale of the Sinès LNG terminal (ENI.II)</u>	151
	<u>Carrico underground storage (ENI.III)</u>	153
	<u>Anticipated sale of the network to REN and guarantees for Access to the network pending the sale of the network to REN (ENI.IV & V)</u>	153

<u>Campo Maior / Extremadura pipeline (Commitments ENI.VI – IX)</u>	154
<u>Reduction of EDP's share in REN from 30% to 5% (commitment EDP.1)</u>	155
<u>Conclusion on commitments relating to infrastructures and transport rights (ENI.II-IX, EDP.1)</u>	155
<u>EDP's ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry</u>	156
<u>EDP's ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs</u>	156
<u>EDP's access to proprietary information about its competitors' costs and daily gas nominations, conferring on it a significant advantage</u>	156
<u>Conclusion</u>	156
<u>2. Market for ancillary services</u>	156
<u>3. Retail supply of electricity</u>	157
<u>B. Natural Gas markets</u>	158
<u>1. Gas supply to power producers</u>	158
<u>2. Gas supply to LDCs</u>	159
<u>3. Gas supply to large industrial customers</u>	160
<u>4. Alternative market definition: large wholesale market</u>	162
<u>5. Gas supply to small customers</u>	163
<u>X. REMEDIES SUBMITTED BY THE PARTIES ON 26 NOVEMBER 2004</u>	164
<u>A. Description of the 26.11.2004 remedies</u>	164
<u>1. Electricity commitments</u>	164
<u>Reduction of EDP's shares in REN</u>	164
<u>Divestment of Tejo Energia</u>	164
<u>Moratorium concerning the construction of new CCGTs</u>	164
<u>Lease of TER units</u>	164
<u>2. Gas commitments</u>	165
<u>Gas infrastructure</u>	165
<u>LDCs</u>	165
<u>Early termination of the gas supply contracts</u>	165
<u>B. Assessment of the 26.11.2004 remedies</u>	165
<u>1. Electricity markets</u>	166
<u>Wholesale electricity market – horizontal effects</u>	166
<u>Wholesale electricity market – vertical effects of the merger</u>	168
<u>Market for ancillary services – loss of potential competition</u>	169
<u>Retail electricity market – loss of potential competition</u>	169
<u>2. Gas markets</u>	170
<u>Gas supply to power producers</u>	170
<u>Gas supply to LDCs</u>	171
<u>Gas supply to LICs</u>	171
<u>Alternative market definition: large wholesale market</u>	172
<u>Gas supply to small customers</u>	173
<u>3. Conclusion</u>	173
<u>XI. REMEDIES SUBMITTED BY THE PARTIES ON 3 DECEMBER 2004</u>	174
<u>XII. CONCLUSION</u>	174



EUROPEAN COMMISSION

Competition DG

Policy and Strategic Support

OPINION

**of the ADVISORY COMMITTEE on CONCENTRATIONS
given at its 130th meeting on 26 November 2004
concerning a preliminary draft decision relating to**

Case COMP/M.3440-EDP / ENI / GDP

1. The Advisory Committee agrees with the Commission that the notified operation constitutes a concentration within the meaning of Article 3(1)(b) of Regulation 4064/89 and that it has a Community dimension.
2. The Advisory Committee agrees with the Commission that for the purposes of assessing the present operation, the relevant product markets are :-

in electricity :-

- a) the wholesale supply of electricity consisting of the production of electricity at power stations and electricity imported through interconnectors
- b) the provision of balancing power and ancillary services, the exact delineation of this(these) emerging market(s) can be left open;
- c) the retail supply of electricity to Large Industrial Customers (LICs) (HV and MV)
- d) the retail supply of electricity to small customers (i.e. smaller industrial, commercial and domestic customers (LV)

In natural gas, as soon as the product markets are open :-

- e) gas supply to gas-fired power plants (CCGTs)
- f) gas supply to local distribution companies (LDCs)
- g) gas supply to Large Industrial Customers (LICs)

- h) gas supply to small customers (i.e. smaller industrial, commercial and domestic customers)
3. The Advisory Committee agrees with the Commission that for the purposes of assessing the present operation, the relevant geographic markets are as follows:-
- a) the electricity wholesale market is Portuguese in scope and will remain so in the timeframe considered for the purposes of the decision, in particular in view of the different competitive conditions between both Iberian countries that currently exist and are likely to remain in the foreseeable future;
 - b) the retail electricity markets are Portuguese in scope;
 - c) the geographic market for electricity balancing power and ancillary services will remain national;
 - d) with regard to the above gas product markets, that all markets except the market for supply of gas to small customers are national in scope whereas the exact geographic scope of the market for supply to small customers, which can be expected to become national within a short period of time after opening of the market to competition but which is no larger than national, can be left open.
4. The Advisory Committee agrees with the Commission that the notified concentration will strengthen :
- a) EDP's dominant position in Portugal on the market for wholesale electricity
 - b) EDP's dominant position in Portugal on the market for ancillary services
 - c) EDP's dominant position in Portugal on the markets for retail electricity supply to LICs
 - d) EDP's dominant position in Portugal on the markets for retail electricity supply to small customers
 - e) GDP's dominant position in Portugal on the market for the supply of natural gas to CCGTs
 - f) GDP's dominant position in Portugal on the market for the supply of natural gas to LDCs,
 - g) GDP's dominant position in Portugal on the market for the supply of natural gas to LICs
 - h) GDP's dominant position in Portugal on the national market (or on five regional markets) for the supply of natural gas to small customers;

as a result of which effective competition will be significantly impeded in a substantial part of the common market within the meaning of Article 2(3) of the Merger Regulation.

5. The majority of the Advisory Committee agrees with the Commission that the commitments submitted by the parties are insufficient to remove
- a) the competitive concern in the wholesale electricity market resulting from the horizontal effects of the transaction (elimination of the main potential competitor)
 - b) the competitive concerns in the wholesale electricity market resulting from each of the vertical effects :
 - i. the privileged access to gas infrastructure
 - ii. raising of rivals costs
 - iii. access to proprietary information (gas price and daily nomination)
 - c) the competitive concerns in the market for ancillary services
 - d) the competitive concerns in the retail supply of electricity to LICs
 - e) the competitive concerns in the retail supply of electricity to small customers
 - f) the competitive concerns in the market for gas supply to CCGTs
 - g) the competitive concerns in the market for gas supply to LDCs
 - h) the competitive concerns in the market for gas supply to LICs
 - i) the competitive concerns in the market(s) for gas supply to small customers

and that, as a result, the concentration should be declared incompatible with the common market.

A minority abstains.

6. The Advisory Committee agrees to ask the Commission to take into account the remarks and comments made by the Advisory Committee and recommend the publication of its opinion in the Official Journal of the European Communities.

<u>BELGIË/BELGIQUE</u>	<u>ČESKÁ REPUBLIKA</u>	<u>DANMARK</u>	<u>DEUTSCHLAND</u>	<u>EESTI</u>
J. MUTAMBA	----	---	A. BUßMANN	---
<u>ELLADA</u>	<u>ESPAÑA</u>	<u>FRANCE</u>	<u>IRELAND</u>	<u>ITALIA</u>
---	B. DE GUINDOS TALAVERA	J. PELLET	B. DEVINE	G. GALABRÒ
<u>KYPROS/KIBRIS</u>	<u>LATVIJA</u>	<u>LIETUVA</u>	<u>LUXEMBOURG</u>	<u>MAGYARORSZÁG</u>
---	---	I. KUDZINSKIENE	---	---
<u>MALTA</u>	<u>NEDERLAND</u>	<u>ÖSTERREICH</u>	<u>POLSKA</u>	<u>PORTUGAL</u>
---	---	---	---	J. AZEVEDO
<u>SLOVENIJA</u>	<u>SLOVENSKO</u>	<u>SUOMI-FINLAND</u>	<u>SVERIGE</u>	<u>UNITED KINGDOM</u>
---	---	---	Ch. OHLÉN	T. KRAJEWSKA



EUROPEAN COMMISSION

The Hearing Officer



FINAL REPORT OF THE HEARING OFFICER
IN CASE COMP/ M. 3440 – EDP/ENI/GDP

(pursuant to Article 15 of Commission Decision 2001/462/EC, ECSC of 23 May 2001 on the terms of reference of hearing officers in certain competition proceedings - OJ L 162, 19.6.2001, p. 21)

On 9 July 2004, the Commission received notification, pursuant to Article 3(1)(b) of Council Regulation No 4064/89, of a proposed merger under which the undertakings EDP and ENI would acquire joint control of the undertaking GDP.

At the end of the first stage of the procedure, the Commission concluded that the transaction raised serious doubts as to its compatibility with the common market. On 12 August 2004, therefore, the Commission initiated proceedings in accordance with Article 6(1)(c) of the Merger Regulation.

On 12 October 2004, the Commission sent the parties a statement of objections in which it concluded, on a provisional basis, that the proposed transaction was incompatible with the common market since it would (i) reinforce EDP's dominant position on the Portuguese electricity wholesale and retail markets and on the market for the supply of ancillary services and (ii) reinforce GDP's dominant position on the Portuguese markets for the supply of gas to combined-cycle plants, large industrial customers and local distribution companies and on the market for the supply of gas to small customers (industrial, commercial and individual).

The parties were given access to the file by means of a CD-Rom which was sent with the statement of objections. They replied to the statement of objections on 27 October 2004. The parties waived the right to a formal hearing.

On 28 October 2004, the parties offered commitments designed to meet the competition concerns identified by the Commission in its statement of objections. The proposed commitments were the subject of a market test, whose result was communicated to the parties. The commitments were deemed to be quite insufficient by the Commission. On 17 November 2004, the parties submitted new commitments involving only slight changes to those initially submitted.

On 19 November 2004, the Commission sent the Members of the Advisory Committee on Concentrations a draft Decision pursuant to Article 8(3) of the Merger Regulation declaring the proposed merger, as amended by the proposed commitments, incompatible with the common market.

The case does not call for any particular comments as regards the right to be heard.

Brussels, 29 November 2004.

(signed)

Serge DURANDE