

***Case No COMP/M.4517 -
IBERDROLA /
SCOTTISH POWER***

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**REGULATION (EC) No 139/2004
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 26/03/2007

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 26.03.2007

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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sir/Madam,

**Subject: Case No COMP/M.4517 – IBERDROLA / SCOTTISHPOWER
Notification of 12 January 2007 pursuant to Article 4 of Council
Regulation No 139/2004¹**

INTRODUCTION

1. On 12/01/2007, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 ("Merger Regulation") by which the undertaking Iberdrola, S.A. ("Iberdrola", Spain) acquires within the meaning of Article 3(1)(b) of the Merger Regulation control of the whole of the undertaking Scottish Power plc ("ScottishPower", UK) by way of purchase of shares. This decision replaces that adopted on 15/02/2007.

I. THE PARTIES

2. **Iberdrola** is active in the generation, distribution and supply of electricity, the wholesale and retail supply of gas, gas import infrastructures, engineering, construction and real estate services. Its activities are focused mainly in Spain and Latin America, and to a lesser extent, in some other European countries (Portugal, France, Germany, Greece and Poland).

¹ OJ L 24, 29.1.2004 p. 1.

3. **ScottishPower** is active in the generation, transmission and distribution of electricity, the supply of electricity and gas as well as gas storage facilities. It is present almost exclusively in the UK as well as, to a minor extent, in Ireland.

II. THE OPERATION

4. The proposed concentration consists of the acquisition of sole control by Iberdrola of ScottishPower. Iberdrola will acquire the entire share capital of ScottishPower by way of a Court sanctioned scheme of arrangement or, alternatively, by way of a takeover offer.

III. THE CONCENTRATION

5. In both hypotheses, Iberdrola will acquire sole control of ScottishPower. The transaction therefore constitutes a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

IV. COMMUNITY DIMENSION

6. The parties have a combined worldwide turnover of more than €5,000 million (Iberdrola €11.7 billion; ScottishPower €7.9 billion). The individual Community-wide turnover for each of at least two of the undertakings concerned exceeds €250 million (Iberdrola €[...] billion; ScottishPower €[...] billion). Whereas Iberdrola has achieved more than two-thirds of its aggregate Community-wide turnover in Spain, ScottishPower has achieved more than two-thirds of its aggregate Community-wide turnover in the UK. The parties have, in other words, not achieved more than two-thirds of their aggregate turnover within one and the same Member State.
7. The concentration therefore has a Community dimension under Article 1(2) of the Merger Regulation.

V. RELEVANT MARKETS

8. The main impact of the transaction is for the financial electricity trading and CO₂ emissions rights trading markets, where the parties' activities currently overlap, and for the electricity markets, where it is highly likely that the parties' activities will overlap in the near future due to Iberdrola's plans to develop wind farms projects for power generation. The assessment will therefore be focussed on these markets.

A Relevant product markets

9. In line with previous Commission decisions dealing with the electricity and gas sectors, the parties have considered the following relevant product markets.
10. For the electricity sector: (i) generation and wholesale supply, (ii) transmission (via high-voltage grid), (iii) distribution (via low-voltage grids), and (iv) retail supply, which can be further segmented into (a) large industrial customers and (b) smaller industrial, commercial and domestic customers.²

² Cases COMP/M.3440 EDP/GDP; COMP/M.3696 E.ON/MOL; COMP/M.3868 DONG/Elsam, COMP/M.4110 - E.ON/ENDESA and COMP/M.4180 - GDF/Suez.

11. The applicability of these previous findings to the notified transaction has been confirmed by the market investigation. In particular, it has been confirmed for Great Britain by market participants and the regulator alike that one should not make a distinction between the different sources of electric energy (gas-fired, coal-fired, nuclear and hydroelectric power stations, wind farms or others) within the market for electricity generation.
12. In addition, the Commission has in previous decisions dealt with the markets for financial electricity trading³ and for trading of CO₂ emission rights⁴ and considered them as separate relevant product markets.
13. As far as CO₂ emission rights are concerned, the applicability of the Commission's findings in previous cases to the notified transaction has been confirmed by the market investigation.
14. As far as electricity trading is concerned, while a majority of respondents to the market investigation consider financial trading as a separate relevant product market, a sizeable minority of respondents consider electricity trading as a whole, including physical trading, to be a relevant product market. The latter respondents thus do not confirm the market definition adopted in an earlier decision in which financial trading of electricity was considered not to form part of the wider market for generation and wholesale of electricity⁵ or they point out that it may have been influenced by the situation considered in earlier decisions. For the case at hand, the precise market definition for financial electricity trading can be left open, since the notified transaction will not give rise to competition concerns in any alternative product market definition.

B Relevant geographic markets

15. In earlier decisions the Commission has generally defined the wholesale electricity market as a national rather than an international market⁶. It has sometimes left open the possibility that markets might be broader. In the light of Council Directives 2003/54/EC and 2003/55/EC, it has to be considered whether bigger markets may be emerging. To decide whether a market is merely national or has a broader dimension, the Commission has often looked at restrictions on the capacity available at the interconnectors with neighbouring countries..
16. The parties consider all electricity markets to be not wider than national. In the case at hand, "national" refers to Great Britain, i.e. England, Wales and Scotland, alias the United Kingdom minus Northern Ireland.
17. Both the undertakings replying to the market investigation and the competent regulator Ofgem concur that the above-mentioned electricity markets are in the case at hand to be

³ Cases COMP/M.3868 – DONG/ELSAM/ENERGI E2 and COMP/M.4180 GDF/Suez.

⁴ Cases COMP/M.3868 – DONG/ELSAM/ENERGI E2 and COMP/4410 - E.ON/ENDESA. Also COMP/M.4376 Dresdner Bank/Gazprombank/JV.

⁵ Case COMP/M.3868 – DONG/ELSAM/ENERGI E2.

⁶ COMP/M.3075 to 3080, 13 December 2003; COMP/M.3318 *ECS/Sibelga*, 19 December 2003. COMP M.3440 *EDP/ENI/GDP*, COMP/4410 - E.ON/ENDESA and COMP/M.4180 - GDF/Suez.

geographically delineated as Great Britain as regards generation and wholesale, transmission and retail markets, while for distribution, it is in general considered to be local

18. The parties refer to previous Commission decisions which have considered that the markets for financial electricity trading and for trading of CO₂ emission rights have EEA and EU geographic dimensions respectively.
19. The applicability of these previous findings to the notified transaction has been confirmed by the market investigation.
20. However, for the case at hand, the precise geographic market definition can be left open as the notified transaction will not lead to competition concerns under any alternative geographic market definition.

VI. COMPETITIVE ASSESSMENT

21. As regards the electricity and gas sectors, ScottishPower is only active in the UK and, to a minor extent, in Ireland. Iberdrola is not currently active in these countries and therefore there are currently neither horizontal overlaps nor vertical relationships stemming from the transaction. However, Iberdrola has concrete plans to enter the UK power generation market with several wind farm projects which will become operational in the near future.
22. In addition, both parties are active in the markets for financial electricity trading and CO₂ emissions rights trading at European level.

A Horizontal overlaps

23. The concentration results in two actual horizontal overlaps and one future: (i) financial electricity trading and (ii) trading of CO₂ (both at present) and (iii) electricity generation (in the future).

Current horizontal overlaps

24. The parties claim that their combined market shares in the markets for financial electricity trading and CO₂ emissions rights trading are very low and do not give rise to affected markets. The parties have also indicated the problems they have faced to obtain reliable third party data on these markets and the difficulties to estimate the market size and therefore the market shares.
25. However, the parties have been able to give their best estimates of their combined market shares for these markets. For the financial electricity trading market, the parties estimate a combined market share of around [0-5]%. As regards CO₂ emissions rights trading, they estimate a combined market share of below [0-5]%.
26. The market investigation confirms that competition on both markets will not be negatively affected by the concentration.

Future horizontal overlap

27. Previous decisions have, in addition to market shares, relied on the place of operators' generation assets on the merit curve to identify market power and barriers to entry on markets for electricity generation.⁷ In this case, where the only overlap constitutes future generation capacity, such approach is not pertinent. This is all the more the case as the overlap consists in wind power, a source of electricity which is insufficiently important in the total generation portfolio and too dependent on factors beyond the operators' will (viz. wind strength) to play a role in a merit curve analysis.
28. Iberdrola has provided its projected new generation capacity for the wind farm projects and a prospective market share analysis for all the main electricity generators for the years from 2006/2007 until 2012/2013, for Great Britain and for Scotland. The projections take into account projects under construction. Iberdrola's projected market share is thus estimated to evolve over this period from [0-5]% to [0-5]% of generation capacity in Great Britain and from [0-5]% to [0-5]% in Scotland.
29. Should the proper geographic market be - as was discussed in paragraph 17 - Great Britain, the market share for this geographic area shows a combined share of between [5-10]% and [5-10]% in installed electricity generation capacity in Great Britain in the years until 2012/2013. Several other players, British Energy, E.ON, RWE and Scottish & Southern Energy (SSE) have larger shares and other players include Centrica and EDF. It follows that Iberdrola's projected wind farm projects are unlikely to have any significant impact on the electricity generation market in Great Britain.
30. The above remains true, even if one were, despite the conclusion to the contrary in paragraph 11, to consider particular methods of generation separately. Iberdrola's projected market share in Great Britain is estimated to evolve between 2006/2007 and 2012/2013 from [0-5]% to [0-5]% in renewable electricity generation capacity and from [0-5]% to [0-5]% in wind farm generation capacity . The combined share of the parties to the concentration in Great Britain would fluctuate between [10-20]% and [10-20]% in renewable electricity generation capacity and between [10-20]% and [20-30]% in wind farm generation capacity. In both alternative product market definitions, there are sizeable competitors including Centrica, E.ON and SSE, and the merged entity would in neither alternative become the market leader.
31. Finally, even if, contrary to what has been indicated in paragraph 17, Scotland were considered as the relevant geographic market, no concern would arise, as the combined market share of the parties would not exceed [30-40]% of all generation sources, with Iberdrola's contribution being very small (ScottishPower [30-40]%; Iberdrola [0-5]%). Also on this narrow geographic basis and seen specifically for renewable sources and wind generation, the combined market shares would be below [20-30]%, with overlaps derived from Iberdrola's future activities remaining below [0-5]%. Again, the merged entity would in none of these alternatives become the market leader.
32. In light of the above, the notified transaction does not raise competition concerns of a horizontal nature.

B Alleged behavioural pattern

⁷ See e.g. M.4180, GDF/Suez, paragraphs 753-755.

33. In the market investigation one respondent has alleged that Iberdrola, on the Spanish markets on which it is active, has shown a behavioural pattern of abusing a dominant position. It has been suggested that this is relevant to the proposed merger.
34. The alleged behavioural pattern refers to the market for balancing services in Spain. In the absence of any current or foreseen activities by ScottishPower in Spain, there are no overlaps on Spanish energy markets. It is therefore not clear how the allegedly abusive behaviour in Spain, which the Spanish competition and/or regulatory authorities are best placed to assess, are related to the proposed concentration.
35. The allegation is that this "pattern", which allegedly has been seen in Spain, would risk to be repeated in the relevant British markets and that Iberdrola therefore would be an unsuitable acquirer of ScottishPower. In particular, this respondent mentioned the NLOANSSE constraint within Scotland, and the Cheviot constraint between England and Scotland. The arguments behind this allegation are however not convincing. The Cheviot constraint affects mainly the electricity flow from Scotland to England, and not vice versa, given the Scottish surplus of power generation.
36. In addition, and most importantly, it does not appear from the market investigation that ScottishPower is in a dominant position on any British energy market or that the proposed concentration would significantly strengthen the company's market power⁸. Absent any such indication of market power it is not clear how the proposed concentration could affect Scottish Power's current incentives or ability to act in an anti-competitive manner on the British markets for balancing power or on any other relevant market.
37. It follows from the above that the conclusion reached in paragraph 32 above is not affected by the allegations about Iberdrola's behaviour on certain Spanish energy markets.

C State aid issue

38. The Commission has to examine all competition issues arising from a proposed merger, including "the consequences which the grant of State aid to those undertakings has on the maintenance of effective competition in the relevant market"⁹. In the context of the proposed merger, commentators have made reference to two different aspects of Spanish tax law which Iberdrola may benefit from on the occasion of the acquisition of ScottishPower and which, according to these commentators, might constitute aid within the meaning of Article 87(1) of the EC Treaty.
39. The first aspect concerns the ability for companies purchasing shareholdings in foreign companies directly to offset up to 15% of the price paid against tax to the extent to which the purchase leads to increased export activities. The Commission has on 22 March 2006 declared this scheme incompatible with the common market and requested

⁸ Ofgem, the British electricity and gas regulator, has indicated that the only constraint is in the direction into England and not North into Scotland, for the foreseeable future. Moreover, the connexion between GB and Scotland, limited to 2.200 MW, is planned to be upgraded (up to 2.800 MW according to Iberdrola). In addition, Ofgem has not raised any competition concern on any other market, either in GB as a whole or in Scotland in particular.

⁹ Judgment of the CFI of 31 January 2001, RJB Mining/Commission, T-156/98, ECR p. II-337, point 114.

Spain to gradually repeal it by 2010¹⁰. Spain amended its national legislation as requested by the Commission. As a consequence of this decision and Spain's compliance, the percentage of this offsetting possibility has since 1 January 2007 been reduced to 12%.

40. The Commission has asked Iberdrola whether it has relied on this provision on the occasion of preceding acquisitions, and which percentage could be offset on these occasions. Iberdrola has replied that the provision has applied to previous acquisitions, which were in Latin America, and that the tax reduction amounted to low percentages, in any case below [0-5]%. It is not clear whether and if yes, to what extent, Iberdrola would be able to convince the Spanish tax authorities that the transaction will lead to increased exports from Spain. If this were to be the case, it is in any case unlikely to be of greater magnitude than was the case with the acquisitions in Latin America. On that basis, it seems reasonable to consider as "worst case" scenario that a one-off tax reduction of [0-10]% of the acquisition price of ScottishPower could be obtained. On the basis of a value of 17.100 million EUR this would mean a one-off tax reduction of [500-1000] million EUR. As a comparison, the turnovers of Scottish Power and Iberdrola in 2006 were approximately EUR 7.985 million and EUR 11.738 million respectively.
41. The second aspect refers to the possibility for Spanish companies purchasing shareholdings in foreign companies to amortize the cost of financial goodwill. To date, this incentive has not been examined under the state aid rules by the Commission, nor has Spain notified the scheme for State aid review.
42. For the purposes of this decision it is neither necessary nor appropriate to determine whether or not the second incentive involves State aid. Indeed, it is important to emphasize that this assessment is entirely without prejudice to the Commission's eventual position on the existence and, if relevant, the legality of any such State aid.
43. The Commission has asked Iberdrola to calculate the net present value of the second tax incentive. This calculation yields EUR [1.000-1.500] million.
44. The two advantages mentioned above could, if available to Iberdrola, increase its financial and commercial strength. The decisive question is whether such a strengthening could raise competition concerns under the Merger Regulation. This could be the case if the financial strengthening of the company, in the light of its existing market position and seen in relation to the financial and competitive position of other market players, would threaten to significantly impede effective competition on the relevant markets.
45. First, although it is not certain to what extent Iberdrola may convince the relevant Spanish authorities that the acquisition will lead to increased export activities, it is clear that the first tax incentive, should it be available, could involve a significant financial strengthening of Iberdrola.

¹⁰ Proposal of appropriate measures under article 88(1) EC on the aid scheme implemented by Spain in the form of direct tax incentives in favour of export related investments - Aid E 22/2004 ex NN 13/2004; Commission press release IP/06/355. Both available on the Commission website.

46. Secondly, it has been shown in paragraphs 23-32 above that the Commission does not consider that the notified operation would significantly impede effective competition on any relevant market. There are no indications that the importance of these tax incentives, even though, as explained above, they could provide tax reductions reaching up towards [1,5-2,5] billion EUR, or around [20-30]% of Scottish Power's turnover in 2006, could put the merged company in a position which would weaken the competitive constraint exercised by its rivals on the energy markets in Great Britain (or in Spain to the extent potentially relevant, given that this issue deals with a Spanish tax incentive which favours activities outside Spain). The main rivals of the parties to the concentration on the British electricity generation market include E.ON, EDF, RWE, SSE and Centrica, who have comparable or more important turnovers and comparable or more important equity. The said tax incentives can therefore not be considered to have a significant impact on effective competition on British energy markets.
47. It follows that even a worst case scenario as regards potential state aid considerations does not alter the above analysis.

VI. CONCLUSION

48. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EC) No 139/2004.

For the Commission,
signed
Neelie KROES
Member of the Commission