EDP/ENI/GDP: the Commission prohibits a merger between gas
and electricity national incumbents

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On 9 December 2004, the European Commission
decided to block the proposed acquisition of Gás
de Portugal (GDP), the incumbent gas company in
Portugal, by both Energias de Portugal (EDP), the
incumbent electricity company in that same
country, and ENI, an Italian energy company.
After an in-depth investigation, the Commission
concluded that the deal would have strengthened
EDP’s dominant position, notably in the Portu-
guese electricity wholesale and retail markets, and
GDP’s dominant position in the various gas
markets in Portugal, as a result of which effective
competition would have been significantly
impeded.

This case illustrates how a given merger may lead
to different anticompetitive effects. The Commis-
sion’s decision relies on the horizontal effects of
the merger on some of the affected markets (elimina-
tion of a significant potential competitor), as
well as on various vertical effects (essentially,
input foreclosure in the wholesale electricity
market and customer foreclosure in some gas
markets).

I. The notified operation

On 9 July 2004, Energias de Portugal (‘EDP’) and
ENI notified a concentration concerning the acqui-
sition of joint control over Gás de Portugal (GDP).
The former Merger Regulation, Regulation 4064/
89, was applicable in this case as the underlying
binding agreement was concluded before 1 May
2004, the date of entry into force of the new
Merger Regulation (2).

EDP is the incumbent electricity operator in
Portugal. As such, its main activities consist of
generation, distribution and supply of electricity in
Portugal. EDP has also recently acquired joint
control of Portgás, one of the six Portuguese local
gas distribution companies (‘LDCs’). In addition,
EDP is active in Spain where it has substantial
electricity and gas activities through its Spanish
affiliates (Hidrocantabrico and Naturcorp) (3). ENI
is an Italian company active internationally at all
levels of the energy supply and distribution chain.

GDP is the incumbent gas company in Portugal. It
is a wholly owned subsidiary of the Portuguese
company Galp Energia currently jointly controlled
by the Portuguese State and ENI, with interests in
both the oil and gas sectors. GDP and its subsi-
diaries cover all levels of the gas chain in Portugal.
GDP has exclusive rights for import, storage,
transportation and wholesale supply of natural gas.
Natural gas is imported into Portugal by GDP’s
subsidiary, Transgás, through a Maghreb-Spain-
Portugal pipeline and through the Sines liquefied
natural gas (LNG) terminal. GDP is also respon-
sible for the transport and supply of natural gas
through the Portuguese high-pressure gas pipeline
network and is about to operate the first under-
ground natural gas storage caverns in Portugal.
Finally, GDP is active in the natural gas supply to
large industrial customers and also controls five of
the six LDCs in Portugal.

The notified concentration was part of a wider
operation including the transfer of the gas trans-
mis ion network, currently owned by GDP, to
Rede Eléctrica Nacional SA (‘REN’), the Portu-
guese electricity grid operator. The transfer of the
network constituted a distinct concentration,
which fell under the competence of the Portuguese
Competition Authorities.

II. Market definitions retained by the
Commission

a. Relevant electricity markets

As regards electricity, the Commission identified
the following affected markets: the market for the
wholesale supply of electricity, the provision of

(1) The authors are part of the EDP/ENI/GDP case team which was managed by Paul Malric-Smith and also comprised Miguel de la
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L 24, p. 1.
(3) See Cases COMP/M 3448 — EDP / Hidroeléctrica del Cantábrico. and COMP/M.2684 — EnBW/EDP/Cajastur/Hidrocantabrico.
regulating/balancing power services (1), and the markets of retail supply of electricity to large industrial customers and to smaller customers (2). All these markets were found to be of national dimension.

**Wholesale supply of electricity**

As in previous decisions, the Commission considered the market for wholesale electricity as a distinct market, which encompasses the production of electricity at power stations as well as electricity imported through interconnectors for the purpose of resale to retailers. The Commission took specific account of the ongoing evolution of the current Portuguese regulatory framework. Until 2004 most of the electricity produced in Portugal (around 80%) was supplied by power stations pursuant to long-term power purchase agreements (‘PPAs’) that provided for the exclusive supply of electricity to a single buyer, REN, under regulated tariffs. EDP was the main generator operating in this regulated segment of the market. However, in view of the future termination of the PPAs and the end to the exclusive relationship between REN and the producers, the Commission took the view, as the parties did, that the wholesale market includes all the previously regulated generation, given that the latter will also be available on the open market.

With respect to the geographic scope of the wholesale market, the level of interconnections (as well as the frequency of congestions) with Spain clearly confirmed that it currently remains a national market. The parties nevertheless called for a ‘transitional market approach’, arguing that the market would become Iberian in scope once the Iberian trading market, called MIBEL, was established. This view was not confirmed by the Commission's in-depth investigation. In particular, the Commission established that many important regulatory barriers would still have to be removed for the purpose of the establishment of the MIBEL and that competitive conditions between Spain and Portugal were likely to remain significantly different even after the launch of the MIBEL. The information gathered by the Commission also showed that the projected level of interconnection capacity between Spain and Portugal would not allow effective integration of both markets in the foreseeable future.

**Retail supply of electricity**

As concerns electricity retail supply, which involves the sale of electricity to the final consumer, the Commission came to the conclusion that two distinct markets should be considered for the purpose of the decision: the supply of electricity to Large Industrial Customers (‘LICs’) which are connected to the high and medium voltage (‘HV’ and ‘MV’) grid, and the supply of electricity to smaller industrial, commercial and domestic customers which are connected to the low voltage (‘LV’) grid (essentially, because of their respective consumption patterns as well as the terms and conditions under which they purchase electricity). Conversely, no further distinction was made between customers purchasing electricity in the regulated system (in which tariffs are determined by the national regulator) and those who are in the non-regulated system, since consumers can choose freely to be supplied under either system depending on the prices and conditions applied.

**b. Relevant Natural Gas markets**

By contrast to the electricity markets, which have been fully open to competition since mid-2004, the Portuguese gas markets were still under a legal monopoly at the time of the proposed transaction. However, the second gas directive (EC/2003/55) provides for a clear and binding calendar pursuant to which 33% of the Portuguese gas market should be liberalised at the latest by 2007, all non-residential customers at the latest by 2009 and all customers at the latest by 2010. In addition, information provided by the parties showed that the Portuguese government had then decided to anticipate the liberalisation process by making the supply of gas to power producers open to competition possibly in 2005.

The Commission, taking into consideration this regulatory framework, identified four distinct affected gas markets: (i) supply of gas to power producers (gas-fired power plants, so-called ‘CCGTs’ (3)); (ii) supply of gas to LDCs; (iii) supply of gas to LICs; and (iv) supply of gas to

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(1) See also Case COMP / M.3268-Sydkraft/Graninge. In the EDP/ENI/GDP decision, the Commission identified the provision of balancing power and ancillary services as an emerging market, the exact delineation of which could be left open. For the purpose of the present article, this market is not discussed further.

(2) The markets relating to the operation of transmission (high voltage) and distribution (low voltage) grids was not affected by the concentration.

(3) CCGTs stands for ‘Combined Cycle Gas Turbines’ power plants.
small industrial, commercial and domestic customers.

The question arose as to whether non-retail customers, i.e. power producers, LDCs and LICs should be considered as part of a single, wider wholesale market. Several elements gathered during the in-depth investigation revealed that they were strong differences between these markets. As regards more specifically the supply of gas to power producers, it was apparent that not only it would be the first market to be opened to competition in Portugal, but also that power producers have unique demand needs in terms of quantity and flexibility of supply. More generally, the market investigation also revealed significant differences between power producers, LDCs and large industrial customers in terms of margins, customer relationships, commercial needs and growth dynamics.

III. Competitive assessment

a. Electricity markets

Wholesale electricity

The Commission found that EDP holds a dominant position on the wholesale market for electricity in Portugal, irrespective of whether it is considered under the current structure or after the termination of the PPAs. The Commission noted in particular that EDP's generation portfolio would remain unmatched. In addition to being the largest importer of electricity, EDP indeed holds [70-80]% of generation capacity and accounts for [70-80]% of generation in Portugal. Pursuant to the Court's case-law (1), the Commission also took account of the advantages that would derive from the state aid scheme to be put in place in order to compensate existing power generators for the termination of the PPAs. Finally, the in-depth investigation revealed that EDP's new CCGT ('TER') would be a significant element of EDP's market power whereas the construction of new CCGTs by other electricity operators in the near future was still very uncertain.

In assessing the effects of the transaction, the Commission then found that the operation would significantly impede effective competition through the strengthening of EDP's dominant position as a result of horizontal and non-horizontal effects.

As for the horizontal effects, the Commission considered that, absent the merger, GDP would have been the most timely, likely and effective competitor in the wholesale electricity market in Portugal. The Commission noted inter alia that having access to competitive gas resources confers a significant advantage in electricity as CCGTs now constitute the most common way of generating new power. The entry of GDP in wholesale electricity was all the more likely to be successful as it could have relied on its national brand and its existing gas customers, to whom it could have offered a joint supply of gas and electricity. This analysis was largely confirmed by confidential documents gathered by the Commission. This significant potential competition would have been lost after the merger without being compensated by other elements, thereby strengthening further EDP's dominant position and significantly impeding effective competition.

The Commission also found that, by allowing EDP to acquire the dominant supplier of gas, which is the main input for the production of electricity today, the operation would have caused various non-horizontal effects, each of which would have significantly impeded effective competition through the strengthening of EDP's dominant position.

First of all, EDP would have had a significant competitive advantage over its existing competitor by gaining immediate access to proprietary information regarding its gas supplies (both in terms of prices and daily needs). Given the volatility of a CCGT's production, such information would have allowed EDP to raise its prices at critical moments. Such a structural advantage was also likely to deter further entries. Second, EDP would have had the ability and the incentive to maintain a privileged and preferential access to the Portuguese gas infrastructure (Sines LNG terminal, import pipeline and underground storage) to the detriment of companies actually or potentially involved in electricity generation. Given the lack of free capacity for third parties even if third parties' access were applied, the operation would thus have provided EDP with all the necessary means and incentives to make access to the gas network more difficult for its competitors. Finally, the merged entity would have had, immediately or in the near future, the ability and the incentive to raise its rivals' costs, thereby foreclosing actual and potential competition.

Retail markets for electricity

On the retail markets, the Commission's investigation confirmed that EDP currently holds a dominant position. Such a position would have been significantly strengthened and effective competition significantly impeded because of the elimination of GDP, which would have been the most likely and effective potential entrant on these markets thanks to its wide gas customer base, its well-known national brand as well its ability to make dual-fuel offers. Moreover, after the acquisition of its main potential competitor, EDP would have remained the only company able to propose within a short period of time dual-fuel offers whereas, absent the merger, both companies would have been in a position to do so for the benefit of consumers.

b. Gas markets

As regards GDP's position on the affected gas markets, the Commission's investigation confirmed that GDP was currently dominant (except for the distribution of gas in the area of Porto where Portgás — a company in which EDP has recently acquired joint control — is active) and would continue to enjoy this position after the opening of the markets thanks to its significant incumbency advantages. According to the Commission, GDP's dominant position would have been strengthened in various ways by the merger, depending on the gas markets under consideration, as a result of which effective competition would have been significantly impeded.

Gas supply to power producers and to LDCs

With respect to these markets, the Commission relied on the vertical effect of the merger by considering that the merger would lead to a significant foreclosure of the challengeable demand. On the market for gas supply to CCGTs, the operation would have foreclosed all the gas demand of CCGTs which, absent the merger, could have been challenged by competitors of GDP once CCGTs are eligible. As to gas supply to LDCs, the merger would have foreclosed the gas demand of the only LDC which is so far not controlled by GDP, namely Portgás. Further to the operation, gas supply to LDCs would have no longer been challengeable by gas competitors.

Gas supply to LICs and to small customers

On these markets, the Commission's investigation revealed that, absent the merger, EDP would have been the most likely and effective potential entrant. Apart from the fact that effective entry of electricity incumbents in gas markets has been witnessed in other Member States, EDP has already access to large quantities of gas for the operation of its CCGT, which confers a strong incentive to enter the gas supply markets. Besides, EDP can rely on its electricity customers, to which it can offer a joint supply of gas and electricity (dual-fuel), as well as on the experience, the reputation and the customer base of the gas distributor Portgás, which it jointly controls. Concerning Portgás, the Commission also noted that, absent the merger, this company 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 with GDP immediately and effectively for the supply of gas to small customers.

The Commission came therefore to the conclusion that the concentration would remove GDP's main potential competitor and raise further the barriers to entry in these markets, thereby significantly impeding effective competition through the strengthening of GDP's dominant position.

Conclusion

Remedy proposals were submitted by the parties at different stages of the procedure. On the basis of the analysis of these proposals, and following market testing, the Commission concluded that these commitments were insufficient to eliminate the various competition concerns identified and, consequently, had to declare the proposed concentration incompatible with the common market. Since then, an action for annulment has been brought by EDP against the Commission's decision before the Court of First Instance (Case T-87/05).