

***Case No COMP/M.3448 -
EDP /
HIDROELECTRICA
DEL CANTABRICO***

Only the English text is available and authentic.

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

Article 6(1)(b) NON-OPPOSITION
Date: 09/09/2004

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 09.09.2004
SG-Greffe(2004) D/203963

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EC) No 139/2004 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sir/Madam,

Subject: Case No COMP/M.3448 – Electricidade de Portugal/ Hidroeléctrica del Cantábrico.

Notification of 05.08.2004 pursuant to Article 4 of Council Regulation No 139/2004¹.

1. On 05.08.2004, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 (“The Merger Regulation”) by which the Portuguese undertaking Electricidade de Portugal S.A. (“EDP”) acquires within the meaning of Article 3(1)(b) of the Council Regulation control of the whole of the Spanish undertaking Hidroeléctrica del Cantábrico S.A. (Hidrocantábrico) by way of purchase of shares. Presently Hidrocantábrico is jointly controlled by Energie Baden-Württemberg (“EnBW”), which is a subsidiary of EDF, EDP and Cajastur.

I. THE PARTIES

2. EDP is the incumbent electricity company in Portugal and active in generation, distribution and supply of electricity power, telecommunications and information technology. EDP also jointly controls the Spanish company Hidrocantábrico². In addition the group is active in water supply, engineering, laboratorial analysis, professional training and real estate management.

¹ OJ L 24, 29.1.2004 p. 1.

² See Case COMP/M.2684-EnBW/EDP/Cajastur/Hidrocantábrico. EDP holds a 40% share in Hidrocantábrico.

3. Hidrocantábrico is active in the generation, distribution and retail of electricity. It is the fourth largest electricity producer and retailer in Spain. It is also active in the distribution and retail of gas and telecommunications.

II. THE OPERATION

4. The proposed transaction is a change in the structure of control over Hidrocantábrico, passing from a situation of joint control by three shareholders EDP, EnBW and CajAstur, to a situation of sole control by EDP. The structure of joint control over Hidrocantábrico was cleared by the European Commission on 19th March 2002 (case COMP/M.2684 - EnBW / EDP / CajAstur / Hidrocantábrico).
5. The current distribution of shares in Hidrocantábrico is the following: EDP (39,51%), EnBW (34,6%), CajAstur (17,5%), Cáser (7,1%) and other shareholders (1,2%). The transaction will be executed through the acquisition by EDP of an additional 56.2% stake in Hidrocantábrico taking the total EDP ownership to 95.8%. EDP will buy the entire 34.6% stake held by EnBW in Hidrocantábrico and an additional 17.5% and 4.1% stakes from CajAstur and Cáser respectively, leaving CajAstur/Cáser with a combined residual stake of 3% in Hidrocantábrico. The above mentioned 3% stake owned by CajAstur/Cáser is purely financial and it will not confer on the latter controlling rights over Hidrocantábrico.

III. CONCENTRATION

6. The present transaction will result in EDP having sole control over Hidrocantábrico and is a concentration within the meaning of Article 3.1.(b) of the The Merger Regulation .

IV. COMMUNITY DIMENSION

7. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 billion³ (EDP 6,315 million, Hidrocantábrico 1,656 million). Each of EDP and Hidrocantábrico have a Community-wide turnover in excess of EUR 250 million (EDP 5,255 million, Hidrocantábrico 1,656 million), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

V. COMPETITIVE ASSESSMENT

RELEVANT PRODUCT MARKET

8. In its past decisions, the Commission has consistently considered that the supply of electricity and gas to end-customers did not pertain to the same product market because these two sources of energy were not seen as sufficiently substitutable⁴.

³ Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25).

⁴ Low substitutability from the customers' point of view is mainly due to (i) the limited number of applications were they can actually be substituted (main water and space heating and cooking for households and limited industrial applications) and (ii) the high equipment costs induced by switching from one source of energy to the other.

9. The definition of the relevant product market(s) in the electricity sector must take into account the existing degree of market opening thereof. As stated in previous decisions by the Commission⁵ the electricity industry can be divided into at least four different physical stages: (i) generation (the production of electricity in power stations); (ii) transmission (the transport of electricity over high tension cables); (iii) distribution (the transport of electricity over the low tension local cables) and (iv) supply (the delivery of electricity to the customer).
10. Bearing in mind the existing degree of market opening, according to the notifying party the relevant product markets in the Iberian Peninsula are the following:

Wholesale of electricity

11. EDP considers that, at this stage, the relevant product market in mainland Spain is the same as the one defined in the decision of the Commission in case M.2684 - EnBW/EDP/CajAstur/ Hidrocantábrico, in which it was considered that the relevant product market was that of the generation of electricity that is bought and sold through the pool or wholesale market.
12. In Portugal, sales of electricity at wholesale level take place in the regulated sector, which will soon be opened up by the termination of certain Power Purchase Agreements between bound generators and REN (the national grid), and in the opened market (SENV) where electricity is produced in Portugal by unbound generators⁶ and is based on bilateral physical contracts between Portuguese generators and customers or through Spanish interconnection, via Spanish pool or bilateral contracts. Although a pool has been foreseen in the Portuguese legislation it has not been implemented.
13. However, the exact definition of the relevant product markets both in Spain and Portugal can be left open as the transaction will not significantly impede competition.

Electricity retail

14. Electricity retail is a downstream market to the wholesale supply market. The notifying party states that, despite the fact that all consumers are now eligible in Spain, it should not be considered that, at this stage, there is a single retail market considering that there is still a regulated retail market where many clients remain. Thus it is still convenient to define two different product markets (regulated and non-regulated). EDP argues that electricity retail in the open market segment should be the relevant product market. However, because consumers have the choice to switch between the regulated and the non-regulated market, and prices in the regulated market constitute a competitive constraint on the non-regulated market, the distinction between distribution and commercialization activities is increasingly blurred.
15. However, as the transaction will not significantly impede competition, the exact definition of the relevant product market can be left open.

⁵ Joint cases COMP M. 2675 EdF/TXU Europe/West Burton Power Station and COMP M. 2679 EdF/TXU Europe/24Seven

⁶ Those who do not have commercial relationships on an exclusive basis with REN.

Natural gas

16. In its past decisions, the Commission has considered that the supply of gas to end-customers constituted a different product market as the one for the supply of electricity.
17. Supply of gas comprises the following activities: (i) the regulated activity of regasification, transportation and storage of gas, (ii) the regulated activity of distribution of natural gas to tariff consumers and (iii) commercialisation/supply of gas to wholesalers and eligible customers (all customers are eligible as from 01.01.2003).
18. Following market opening, all consumers have the possibility to choose between acquiring gas from distributors (regulated activity with suppliers operating at local level) or in the opened market (commercialisation with suppliers operating at national level). Having regard to the above, even that legal and technical developments are still needed to consider the market as fully opened, it can be considered that distributors compete with companies active in the opened market. Accordingly, in the future the distinction between distribution and commercialisation activities will become increasingly blurred and the geographical dimension of the market would be national even if distributors operate only at local level. Nevertheless, for the purposes of the assessment of this operation the final definition can be left open since the assessment does not change whatever definition is chosen.
19. However, as the transaction does not significantly impede competition, the exact definition of the gas supply market(s) can be left open.

RELEVANT GEOGRAPHIC MARKET

Wholesale of electricity

20. The markets for the wholesale and retail supply of electricity have traditionally been considered by the Commission as no more than national in scope. As regards mainland Portugal or mainland Spain, this has been confirmed in past decisions⁷.
21. In particular, imports to the Spanish market are constrained by the limited interconnection capacity currently available. The commercial interconnection capacity between Spain and neighbouring countries expected for the period 2004/2005 amounts to approximately 2,800 3,250 MW: (1) 1,300-1,400 MW with France; (2) 1,200-1,500 MW with Portugal; and (3) 300-350 MW with Morocco. This represents approximately 7-7.5% of the capacity needed at peak demand times⁸. Imports of electricity in Spain in 2003 amounted to 4.3% of energy sold in Spain. Further, the regulatory framework and the structure of supply (i.e., the organisation of the wholesale market) differ from those of other neighbouring national electricity systems, such as France's and Portugal's.
22. However, the parties submit that, for the purpose of assessing the present case, the relevant geographic market is the Iberian Peninsula because such a market will materialise in the near future: an Iberian electricity Pool ("MIBEL") will start very

⁷ Case M.2684 EnBW/EDP/Cajastur/Hidroeléctrica del Cantábrico of March 2002

⁸ Source: Informe Marco sobre la demanda de Energía eléctrica y gas Natural y su cobertura. Año 2003. Published on 16.3.2004.

soon, leading to a convergence of electricity wholesale prices; the interconnection capacities between Spain and Portugal would significantly expand in the future; regulatory and administrative barriers would be removed and the functioning and management of methods of the system operators would be harmonized.

23. However there are some doubts whether the wholesale electricity market will be in the near future Iberian in scope and there are indications that the markets are currently limited to mainland Portugal and mainland Spain.
24. Notwithstanding this, the question of the precise geographic scope of the market (Iberian or mainland Spain and mainland Portugal) can be left open since the transaction will not significantly impede competition in any event.

Electricity retail

25. The parties consider the market for electricity retail to be national in scope and the traditional approach by the Commission is likely to be still applicable.
26. However, as the transaction will not significantly impede competition, the exact definition of the relevant geographic market can be left open.

Natural gas

27. In its past decisions, the Commission has considered that the markets for the supply of gas are still national in scope. In view of the existing regulatory barriers and the limited international exchanges this relevant geographical market definition can be maintained in the case of Spain and Portugal.
28. As regards the regulated activity of transport of gas, the Commission's view, in line with previous decisions (Case IV M. 1190 Amoco/Repsol/Iberdrola/Ente Vasco de la Energía) is that the market is national.
29. As regards the regulated activity of gas distribution to tariff consumers, the Spanish Competition Authority has considered in the past that the geographical scope is limited to the geographical areas where the suppliers to tariff consumers can operate according to administrative authorisations. The Commission shares this view, given the regulatory geographic barriers.
30. Finally, commercialisation of gas consists in the acquisition of gas from producers or wholesalers, the use of third parties' transport infrastructures (regulated activity) and the sale to other wholesalers or final consumers. According to the parties and the Spanish Competition Authority the geographical dimension of the market is national-wide. This view is shared by the Commission in view of the existing different regulatory regimes.

COMPETITIVE ANALYSIS

31. EDP has already joint control over Hidrocarbúrico and will acquire sole control as a result of the concentration. The parties state that any impact of the transaction would be on the markets of electricity wholesale, electricity retail and natural gas.

Horizontal relationships: electricity wholesale market

Iberian Peninsula

32. If the Iberian Peninsula is considered, both EDP and Hidrocarbónico are active in this market. In the hypothetical future regulatory system, EDP and Hidrocarbónico will not hold more than 20% market share bearing in mind that their total generation market share in the Iberian Peninsula was 18,3% in 2003. Other competitors such as Endesa (35,2% generation market share) and Iberdrola (27,1% generation market share) will also be present on this hypothetical future market.

Spain

33. Hidrocarbónico is a vertically integrated electricity company in Spain and participates at all levels in the electricity chain: generation, wholesale, distribution, retail. However, the parties state that the market is currently dominated by two companies, Endesa and Iberdrola. These companies are also vertically integrated and hold considerable market power in Spain reflected in their shares of total installed electricity generation capacity, their shares of sales to the wholesale market and their ability to set prices in the wholesale electricity market. Also other vertically integrated companies such as Unión Fenosa and Viesgo and other companies such as REE, Elcogas, Gas Natural SDG, EDF, REN, Repsol are active in this sector.
34. As regards the total installed generation capacity, Hidrocarbónico has a market share (2003) of [0-10]%. On the basis of electricity generated, Hidrocarbónico has a market share (2003) of [0-10]%. As regards sales to the pool, Hidrocarbónico has a market share (2003) of [0-10]% and with regard to purchases in the pool, Hidrocarbónico has a market share of [5-15]%. It can thus be concluded that the market shares of Hidrocarbónico in the Spanish electricity wholesale market are low.
35. EDP is already present at Spanish level through its stake in Hidrocarbónico. EDP also participates in the Spanish wholesale market with two other companies: EDP Energia Iberica and EDP Energia S.A.. However, EDP's market share of the Spanish wholesale market is insignificant (far below 0,1%) and the overlap can be regarded as de-minimis. As the transaction will result in a change from joint to sole control, it will not significantly change the structure of the Spanish electricity wholesale market, since EDP already jointly controls Hidrocarbónico.

Portugal

36. As regards EDP's activities in Portugal, the relevant product market is electricity traded at the open wholesale market level (within the current SENV). EDP's market shares are as follows: under the current system EDP would account for [70-80]% of the energy that is sold in the wholesale market (SENV), that is generated by EDP within SENV or imported from Spain.
37. Hidrocarbónico's activities in Portugal are marginal. In relation to generation, Hidrocarbónico was never active in Portugal. It can be concluded that the change from joint to sole control of EDP on Hidrocarbónico will not remove a significant competitive constraint on EDP.

Natural gas

38. For the moment EDP does not carry out any activities in the natural gas sector⁹, apart from its stake in Hidrocantábrico, [...]. Hidrocantábrico's activities are bundled in Naturcorp, which is jointly controlled by Hidrocantábrico and Ente Vasco de la Energía. [...]

Vertical relationships: electricity retail

39. The parties state that electricity retail in Spain and Portugal will be downstream markets to the Iberian electricity wholesale market and the market on which the concentration would have an impact would be in Spain, where Hidrocantábrico carries out its retail activities.

Spain

40. The market share (2003) of Hidrocantábrico is approximately [0-10]% in the regulated segment where strong operators such as Endesa ([30-40]%) and Iberdrola ([30-40]%) are active. In the opened market Hidrocantábrico has a market share of approximately [0-10]% behind other stronger competitors such as Iberdrola ([35-45]%) and Endesa ([30-40]%). If the retail market was considered as a single market (sales to the regulated market and free market), Hidrocantábrico would have a market share of [0-10]%. EDP participates already in this market via its stake in Hidrocantábrico and the change from joint to sole control will not significantly impede effective competition.
41. Based on the above, it can be concluded that the notified concentration will not significantly impede competition in particular as a result of the creation or the strengthening of a dominant position in any of the above mentioned possible relevant markets.

VI. CONCLUSION

42. 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)
Mario MONTI
Member of the Commission

⁹ However, EDP has notified to the Commission (Case M.3440-EDP/ENI/GDP) its intention to acquire joint control with Eni of GALP's subsidiary that carries out activities in the natural gas sector.