

# COMMISSION

## COMMISSION DECISION

of 9 December 2004

**declaring a concentration incompatible with the common market pursuant to Article 8(3) of the Council Regulation (EEC) No 4064/89 (Merger Regulation (ECMR))**

**(Case No COMP/M.3440 — EDP/ENI/GDP)**

(notified under document number C(2004) 4715)

**(Only the English version is authentic)**

**(Text with EEA relevance)**

(2005/801/EC)

*On 9 December 2004 the Commission adopted a Decision in a merger case under Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings<sup>(1)</sup>, and in particular Article 8(3) of that Regulation. A non-confidential version of the full Decision can be found in the authentic language of the case and in the working languages of the Commission on the website of the Directorate-General for Competition, at the following address: [http://europa.eu.int/comm/competition/index\\_en.html](http://europa.eu.int/comm/competition/index_en.html)*

### I. THE PARTIES

- (1) Energias de Portugal, SA (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 Hidroantábrico, 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 % of the shares.
- (2) ENI SpA (ENI) is active in the exploration and production of oil and natural gas worldwide. ENI is also active in the supply, transmission, storage, distribution and trade of natural gas. Moreover, ENI holds shares in companies with transportation capacities which are active in the operation of the trans-national pipelines for transmission of natural gas.
- (3) Gás de Portugal, SGPS, SA, (GDP) is the incumbent gas company in Portugal. GDP is a wholly-owned subsidiary of the Portuguese company Galp Energia, SGPS, SA

(GALP), currently jointly controlled by the Portuguese State 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 a Maghreb-Spain-Portugal pipeline and through the Sines LNG terminal, and is responsible for the transportation, storage, transport and supply through the Portuguese 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 gas distribution companies (LDCs) in Portugal.

- (4) Rede Eléctrica Nacional SA (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.

<sup>(1)</sup> OJ L 395, 30.12.1989, p. 1. Regulation as last amended by Regulation (EC) No 1310/97 (OJ L 180, 9.7.1997, p. 1).

## II. THE OPERATION

- (5) The present case concerns a concentration by which EDP and ENI (the parties) plan to acquire joint control over GDP. The operation foresees that the gas transmission network (i.e. excluding Sines LNG terminal, import pipeline and Carriço underground storage) will be transferred to REN, the Portuguese electricity grid operator within a given timeframe. During a transitory period, EDP will have control over the gas network, along with ENI and REN.
- (6) According to the second gas directive <sup>(2)</sup> and the derogation granted to Portugal, 33 % of the Portuguese gas market shall be liberalised at the latest by 2007, all non-residential customers at the latest by 2009 and all customers (including residential customers) at the latest by 2010. The Portuguese government may decide to start the liberalisation process earlier.

## III. RELEVANT MARKET

### A. RELEVANT ELECTRICITY MARKET

#### 1. RELEVANT PRODUCT MARKET

- (7) Taking into consideration the specifics of the Portuguese markets and the competitive and regulatory framework, the Commission has reached the conclusion that the following markets should indeed be distinguished:
- (i) wholesale supply of electricity,
  - (ii) provision of regulating/balancing power services <sup>(3)</sup>,
  - (iii) transmission grid,
  - (iv) distribution grid,
  - (v) retail supply of electricity (large customers and small customers).
- (8) 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).
- (9) SEP is a regulated system that covers generation and distribution. It is composed of 'bound' generators and 'bound' distribution networks. 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).

- (10) 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 formula <sup>(4)</sup>. 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 Energia <sup>(5)</sup>, and Turbogás <sup>(6)</sup>. Most of the electricity in Portugal (83 % in 2003) <sup>(7)</sup> is supplied through these exclusive PPAs between REN and power producers.
- (11) 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.
- (12) 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.
- (13) 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 Decree Law of 17 August 2004 finally provided that all clients are eligible <sup>(8)</sup>.

<sup>(4)</sup> 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).

<sup>(5)</sup> 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 minority 10 % interest each, which does not seem to confer to either of them the possibility to exercise joint control over the company.

<sup>(6)</sup> 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.

<sup>(7)</sup> 35 TWh out of a total supply of 43 TWh in 2003.

<sup>(8)</sup> 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.

<sup>(2)</sup> 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, 15.7.2003, p. 57).

<sup>(3)</sup> See Case COMP/M.3268-Sydskraft/Graninge.

- (14) (The existing regulatory framework is currently being amended.

### **Wholesale electricity**

- (15) Wholesale electricity 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 consumers 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).
- (16) The Commission considers that, as from the termination of the PPAs, there will be an electricity wholesale market in Portugal encompassing the offer of the former bound generation, the unbound generation and imports. The assessment focuses on this wholesale market irrespective of the liberalised and regulated systems.

### **Balancing power and ancillary services**

- (17) 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.
- (18) 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.
- (19) Currently, in Portugal, this service, as well as other similar ancillary services (congestion management services), is provided by REN to all agents in the system. There is as yet no established market for such services in Portugal. However, it is likely that, after the termination of the PPAs, such a market, or such markets, will emerge. For the purpose of this decision, the exact delineation of this emerging market, or these emerging markets, can be left open.

### **Transmission and distribution**

- (20) 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.

### **Retail supply of electricity**

- (21) The following electricity retail markets will be considered for the purpose of the present statement: (i) the supply of electricity to Large Industrial Customers (LICs) which are connected to the high and medium voltage (HV and MV) grid and (ii) the supply of electricity to smaller industrial, commercial and domestic customers which are connected to the low voltage (LV) grid.
- (22) HV/MV customers and LV customers are very different as regards their consumption and terms and conditions under which they purchase electricity. The commercial relationship is also very different. MV and HV customers are for the most part industrial customers for which electricity may account for a significant part of their costs. On the contrary, most LV customers are small industrials, commercial or domestic customers whose consumption of electricity per consumer is quite limited in volume.

## 2. GEOGRAPHICAL MARKETS IN ELECTRICITY

- (23) In past Commission decisions, the relevant geographic market for the wholesale supply of electricity has been considered to be no wider than national borders<sup>(9)</sup>. In the present case, the investigation has shown that wholesale and retail electricity markets are clearly Portuguese in scope and will remain so in the foreseeable future.
- (24) The parties argued that an Iberian trading market called MIBEL would be established very soon and would thus lead to an Iberian market. This view has not been confirmed by the in-depth investigation carried out by the Commission. It appears that (1) the current level of interconnections between Spain and Portugal is not sufficient to consider the existence of a single market in the Iberian peninsula and (2) it is highly unlikely that the electricity wholesale market will become Iberian in scope in the near future for the following reasons:
- (i) many important regulatory barriers still have to be removed for the purpose of the establishment of the MIBEL;

<sup>(9)</sup> See e.g. Case M. 2434 — Grupo Villar MIR/ENBW/Hidrocantabrico.

- (ii) competitive conditions between Spain and Portugal are likely to remain significantly different even after the launch of the MIBEL;
- (iii) CO<sub>2</sub> emission national allocation plans and national compensation scheme for stranded costs are likely to maintain or even increase these differences in the competitive conditions;
- (iv) the projected level of interconnection capacity between Spain and Portugal is not likely to allow effective integration of both markets in the foreseeable future.

#### B. RELEVANT NATURAL GAS MARKETS

##### 1. PRODUCT MARKET

- (25) The Commission has identified four distinct gas product markets which will be affected by the operation:
  - (i) supply of gas to power producers (CCGTs<sup>(10)</sup>);
  - (ii) supply of gas to local distribution companies (LDC);
  - (iii) supply of gas to large industrial customers (LICs);
  - (iv) supply of gas to small industrial, commercial and domestic customers.
- (26) Six local distribution companies (LDCs) distribute and supply most end-customers through medium and low pressure<sup>(11)</sup> networks and operate in exclusive concession areas.
- (27) The market of gas supply to power producers will be the first to be opened to competition in Portugal. The parties claimed that CCGTs and LICs should be considered as part of a single, wider wholesale market. The Commission does not agree with the parties. Indeed, power producers have unique demand needs in terms of quantity and flexibility of supply. CCGTs therefore need to combine long-term contracts, 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. They also have different margins, customer relationship; commercial needs of resellers and growth dynamics.

##### 2. GEOGRAPHICAL MARKET

- (28) On each relevant gas market, the Commission and the parties agree that the supply of natural gas in Portugal is no wider than national.

#### IV. COMPETITIVE ASSESSMENT

##### A. ELECTRICITY MARKETS

##### 1. WHOLESALE MARKET

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

- (29) 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.
- (30) Indeed, in 2003, in the wholesale market, EDP holds 70 % of generation capacity, accounts for 70 % of generation and is the largest importer of electricity. Moreover, EDP's Portuguese generation portfolio will remain unmatched after the abolition of the PPAs. After the termination of the PPAs, a stranded cost scheme (CMECs) is to be put in place to compensate existing power generators for any possible loss in the market in the future. This scheme favours incumbents. EDP is bound to get most of it, which will help shield EDP from future competition.
- (31) On the demand side, EDP holds close to 100 % of the distribution of electricity in Portugal. EDP Distribuição's future role as the retailer for the regulated system confer EDP crucial advantages.
- (32) On the supply side, the addition of EDP's new gas fired power-plant (TER) is significant in EDP's portfolio. As regard new generation capacities to be built by third parties, the Commission has come to the conclusion that CCGTs projects by competitors are uncertain and that EDP has influence over one of them (Tejo Energia).

##### (b) *The operation will strengthen EDP's dominant position, due to both horizontal and vertical effects*

##### **Horizontal effects: removal of a significant competitor**

- (33) As for the horizontal effects, the Commission came to the conclusion that, absent the merger, GDP would have been very likely to become the main competitor in the electricity markets in Portugal, considering (i) that having access to competitive gas resources confers a significant advantage in electricity as gas-fired power plants (CCGTs) now constitute the most common way of generating new power and (ii) that GDP, as a Portuguese company, could rely on its brand and gas customers, to which it could offer a joint supply of gas and electricity.

<sup>(10)</sup> CCGTs stands for 'Combined Cycle Gas Turbines' power plants.

<sup>(11)</sup> Respectively between 4 and 20 bar and below 4 bar.

(34) This significant potential competition would be lost after the merger, thereby strengthening further EDP's dominant position.

#### **Non-horizontal effects: raising rivals' costs**

*Privileged and preferential access to the Portuguese gas infrastructure (Sines LNG terminal, import pipeline and Carriço underground storage)*

(35) 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.

(36) *High-pressure gas network* further to the merger EDP will be able to have 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 temporary<sup>(12)</sup> period which may last up to 19,5 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.

(37) *GDP's international pipeline* the merged entity would be in a position to use the first existing entry point in Portugal (the pipeline which goes from Algeria to Portugal through Morocco and Spain and which enters Portugal in Campo Maior) at a full capacity in order to prevent competitors to use any freed capacity. Therefore, 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.

(38) *GDP's Sines terminal* the LNG terminal located in Sines 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.

<sup>(12)</sup> 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.

(39) *Carriço underground storage* 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 Sines which is much smaller). 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.

(40) Further to the operation as notified, EDP acquires a significant control over the gas entry points as well as the storage facilities. The operation 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.

*Ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs*

(41) 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 (i.e. Turbogás) and potential competing CCGTs will be supplied by another company but the merged entity. When restrictions occur in gas supply in Portugal, GDP will have the incentive to favour EDP's plants to the detriment of competing CCGTs.

*Ability and incentive to control gas price and raise rivals' costs, thereby foreclosing its actual and potential and deterring entry*

(42) Further to the merger, EDP will have the ability and incentive to raise the price of gas supplied to actual competitors (Turbogás, for its short-term requirements). This holds also true for potential competitors (for the whole of their requirements) since the pace of liberalisation and uncertainties as to the access to entry points makes it likely that future CCGTs, if any, will be supplied with gas by GDP.

*Access to proprietary information about EDP competitors' costs, conferring it a significant advantage:*

(43) The merged entity will be armed with the knowledge of its actual competitors' input costs 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.

*Access to the daily gas nomination of its main proprietary information about its competitors' costs, conferring it a significant advantage;*

- (44) 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 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. Given the volatility of CCGTs' production, this information is strategic: Knowing, for instance, that Turbogás does not plan to generate power at a certain time of the following day, EDP will be in a position to raise its prices above Turbogás' variable costs with no fear of losing sales to Turbogás.
- (45) The abovementioned horizontal and vertical effects, considered individually or together, strengthen EDP's dominant position in the electricity wholesale market.

## 2. ANCILLARY SERVICES

- (46) The present operation will remove GDP as a likely entrant on the electricity market, and therefore a potential provider of ancillary services. Based on all the reasons developed 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.

## 3. RETAIL MARKETS FOR ELECTRICITY IN PORTUGAL

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

- (47) The market for supply of electricity to large industrial customers (45 % of total consumption) is fully eligible. On this market, EDP holds a 92 % market share in volume (much more in customers).
- (48) The small customer market only began to be opened in the course of 2004. EDP holds close to 100 % market share. 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.

### (b) *Strengthening of EDP' dominant position on the retail market for electricity in Portugal*

- (49) 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 wide gas customer base, its well-known national brand as well as its ability to make dual-fuel offers.
- (50) Moreover, the merger will raise further barriers to entry as the merged entity will combine incumbents' advantages in gas and electricity and force competitors to enter simultaneously on the gas and electricity markets to be able to offer dual-fuel.

## B. GAS MARKETS

### 1. GDP HAS A DOMINANT POSITION ON THE PORTUGUESE GAS MARKETS

- (51) Due to its current position of legal monopolist, GDP holds a dominant position in all gas markets, with the only exception of the distribution of natural gas in the area of Porto where Portgás — a company in which EDP has recently acquired joint control — is active.
- (52) GDP enjoys and will keep enjoying after the opening of the markets 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 profile, 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.

### 2. STRENGTHENING OF GDP'S DOMINANT POSITION ON THE PORTUGUESE GAS MARKETS

#### (a) *Gas supply to power producers (CCGTs)*

- (53) As regards the supply of gas to CCGTs, the notified operation will foreclose all the gas demand by CCGTs (namely Turbogás' <sup>(13)</sup> and TER/Carregado's short-term requirements) which could otherwise have been challenged by competitors of GDP, once CCGTs are eligible. This strengthens GDP's dominant position in the market for the supply of gas to CCGTs.

<sup>(13)</sup> EDP's 20 % shareholding in Turbogás confers to it certain blocking rights.

**(b) Gas supply to LDCs (local distribution company)**

- (54) The notified operation will foreclose the gas demand of the only LDC which is so far not controlled by GDP, namely Portgás. Further to the operation, no gas supply to LDCs will be challengeable by gas competitors any longer, when they become eligible. This strengthens GDP's dominant position in the market for the supply of gas to LDCs.

**(c) Supply to gas to LICs (large industrial customers)**

- (55) The investigation has shown that EDP would have been the most likely entrant in the market for supply of gas to large industrial customers, once it is liberalised.
- (56) EDP appears to be the most likely potential entrant in this market, considering (i) that it operates a CCGT for the production of electricity (and hence has access to large quantities of gas), which confers a strong incentive to enter the gas supply markets, (ii) that it could rely on its electricity customers (EDP controls close to 100 % of the electricity distribution in Portugal), to which it could offer a joint supply of gas and electricity (dual-fuel) and (iii) that it could also rely on the experience, the reputation and the customer base of the gas distributor Portgás. The effective entry of electricity incumbents in gas markets has been witnessed in many Member States.
- (57) The loss of EDP's potential competition strengthens GDP's dominant position on the market of gas supply to LICs.

**(d) Gas supply to small customers**

- (58) The Commission has come to the conclusion that, absent the merger, EDP would have been the most likely entrant on the market for the supply of gas to small customers.
- (59) 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).
- (60) EDP's will to enter the gas markets is further evidenced by its recent acquisition of control over a Portuguese LDC, Portgás, and its strong development in gas markets in Spain (EDP acquired control over the second largest gas company in Spain, Naturcorp).
- (61) On the basis of the abovementioned elements, the concentration would remove GDP's main competitor

and raise further the barriers to entry in the market for the supply of gas to small customers. It will thus strengthen GDP's dominant position in the retail gas market in Portugal.

**V. COMMITMENTS PROPOSED BY THE NOTIFYING PARTIES**

- (62) The parties have submitted commitments on 28 October 2004 and an improved version on 17 November 2004. The 17 November 2004 commitments are summarised below, using the parties' numbering:

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 Sines 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 LICs and retail customers in Portugal until the natural gas supply to such customer groups is liberalized

ENI.XIV: Sale of the LDC Setgás.

## VI. ASSESSMENT OF THE COMMITMENTS PROPOSED

### A. COMMITMENTS ON ELECTRICITY

#### 1. WHOLESALE ELECTRICITY MARKET

##### (a) *Horizontal effects of the operation (removal of GDP as the most likely entrant)*

(63) The parties' proposal consists in a combination of measures aimed at ensuring the entry of competitors while, at the same time, avoiding to divest generation assets. It relies mainly on a moratorium concerning the construction of new CCGTs by EDP and the lease of some production capacity of EDP's power plant TER for a limited period of time.

(64) 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. The Commission shares these concerns expressed by third parties.

(65) The lease of production capacity from TER is equivalent to only one third of the plant and would account for 4 % of the total generation capacity in Portugal. The lease can be automatically terminated based on criteria which do not ensure the presence of new competitors nor the actual existence of an Iberian market. The lease can be as short as three years. EDP will know in real-time the costs and volumes of electricity that the lessee can market. All this makes it unlikely that such a lessee might have a significant influence on the market and exercise a competitive constraint on EDP.

(66) Given the review clause attached to the proposed moratorium, the moratorium is likely to end shortly with no insurance that new competitors will actually enter the market. Besides, it does not prevent EDP from starting new CCGT projects (all steps but the actual building). The moratorium and the lease proposed thus fall short of having a pro-competitive effect similar to a structural remedy.

(67) In addition, the parties propose to divest EDP's 10 % share in Tejo Energia, one of EDP's competitor. If this is a positive proposal, it does not at all guarantee that Tejo Energia will actually build a CCGT in the future.

(68) The parties have also proposed to suspend EDP's voting rights in Turbogás. This suspension is limited to a three year period and to only two specific areas of decision. EDP has also recently acquired an option to buy 20 % more share in Turbogás and manage all of Turbogás' production. It is therefore quite doubtful that the parties' commitments will prevent EDP from exercising influence on Turbogás' gas supply policy and future projects.

##### (b) *Non-horizontal effects (raising rival costs)*

##### **EDP's privileged and preferential access to the Portuguese gas infrastructure**

(69) The sale of the Sines LNG terminal and the Carriço underground storage to the gas high-pressure network operator, i.e. an ownership unbundling, is a positive proposal welcomed by the Commission. However, the terms and conditions attached to these transfers do not ensure that a sufficient capacity will be available for third parties. In particular, the remedies explicitly allows subsidiaries of the parties active in gas in Spain, Union Fenosa Gas and Naturcorp, to book further capacity even before the transfer, as well as the parties after the transfer.

(70) The parties also proposed to make capacity available in the Spain-Portugal pipeline at Portuguese entry point (Campo Maior). According to the market test, this capacity is far too small (less than 10 % of this pipeline's capacity, not enough to supply a single 400 MW CCGT unit) and is not ensured in the upstream pipeline (Extremadura pipeline) to bring gas up to the Portuguese border. A mechanism has been included to provide additional capacity but under conditions which make the access to this extra-capacity neither timely, economically feasible nor long-lasting enough for third parties to rely thereon.



- (71) The commitments on natural gas infrastructures are therefore likely to have very limited positive effects on the electricity and gas markets in Portugal.

### Other vertical impacts of the merger

- (72) As regards the other vertical competition concerns<sup>(14)</sup> raised by the operation, the commitments provide mainly for Chinese Walls to limit flows of information between GDP and EDP. The market test clearly indicated that, in the present case, such measures are not sufficient to address these issues.

### 2. MARKET FOR ANCILLARY SERVICES

- (73) The lease of production capacity, as provided for by commitments, do not allow the lessee to be active in the balancing power market, which requires adapting the output of the plant in real-time.

- (74) As explained above, the commitments do not ensure with a sufficient level of certainty that competitors will build new power generation capacities in Portugal in the foreseeable future. As a result, the proposed remedies do not remedy the strengthening of EDP's dominant position in this market.

### 3. RETAIL SUPPLY OF ELECTRICITY

- (75) The only remedy which relates directly to the retail supply of electricity is the *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*. This commitment would only apply for a limited period and in any case, this remedy does not ensure the appearance of competitors to compensate for the loss of GDP.

- (76) Other remedies may indirectly positively affect the retail electricity market but do not ensure that new competitors will effectively enter the retail supply of electricity in Portugal in a timely and sufficiently large way so as to compensate for the loss of GDP's future competition.

<sup>(14)</sup> That is: (i) EDP's ability and incentive to control gas prices and raise its rivals' costs, thereby foreclosing its actual and potential competitors and deterring entry; (ii) EDP's ability to manage the constraints in the gas supply to CCGTs to the detriment of competing CCGTs; (iii) EDP's access to proprietary information about its competitors' costs and daily gas nominations, conferring on it a significant advantage.

## B. NATURAL GAS MARKETS

### 1. GAS SUPPLY TO POWER PRODUCERS (CUSTOMER FORECLOSURE)

- (77) Three commitments directly relate to this concern: (i) the elimination of GDP's right of first refusal for the gas supply of TER, (ii) the suspension of some of EDP's voting rights in Turbogás for three years and (iii) the partial lease of TER.

- (78) (i) Market participants have underlined that the elimination of GDP's right of first refusal to supply TER does not eliminate EDP's incentives to source gas supply from GDP; (ii) the mere suspension of some voting rights for a limited period of time does not prevent EDP's influence on Turbogás' gas supply policy; (iii) the lease accounts only for one third of TER and the lessee will have to buy most of its gas from GDP. The Commission therefore considers that these commitments fall short from addressing the strengthening of GDP's dominant position in the market for gas supply to power producers.

### 2. GAS SUPPLY TO LDCS (CUSTOMER FORECLOSURE)

- (79) The operation forecloses the gas demand of Portgás, the only LDC not controlled by GDP. The gas consumption of the LDC proposed to be divested, Setgás, is four times as small as Portgás'. The commitment therefore does not remove the strengthening of GDP's dominant position in the market for the gas supply of LDCs.

### 3. GAS SUPPLY TO LARGE INDUSTRIAL CUSTOMERS (LICS)

- (80) The only remedies which directly address the concerns raised in this market are the commitments not to engage in dual offers (gas/electricity) before the gas liberalisation of LICs and to offer LICs the possibility to renew their gas contract on a yearly basis. Both remedies fall short from ensuring that a new competitor will enter the gas market for LICs.

- (81) Nevertheless, remedies which may have an indirect impact on this concern have also been analysed: as regards gas import infrastructures, high uncertainties remain as to whether sufficient capacities will be available. Besides, Setgás, which would be divested, accounts for less than 10 % of the gas customers in Portugal and would be a much more limited starting base to enter the LIC market as compared with EDP's electricity and Portgás' gas customer bases.

#### 4. GAS SUPPLY TO SMALL CUSTOMERS

- (82) The divestiture of Setgás is a structural remedy but does not compensate for the loss of EDP/Portgás future competition in the gas retail market: Setgás' sales account for 8 % of the overall gas retail sales in Portugal while Portgás holds a 30 % market share. The commitment not to offer dual-fuel supplies to retail gas customers who are not yet eligible in both gas and electricity is very limited in time and effect. No other remedy has been proposed to directly address the loss of potential competition stemming from EDP's ability to rely on its nationwide electricity customer base, its strong brand and its incentive to provide dual offers (electricity/gas) to customers.

#### VII. LATE REMEDIES

- (83) After the expiration of the deadline set for the submission of remedies <sup>(15)</sup>, on 26 November 2004, the parties submitted documents proposing to amend the remedies already presented, with a view to addressing the concerns raised by the Commission. However, these remedies did not fully and unambiguously remove the competition concerns identified by the Commission.

- (84) On Friday evening 3 December 2004, the parties submitted new set of 'gas commitments' aiming to implement the intentions stated by them in the document sent to the Commission on 26 November 2004. 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 decision, 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, this latest set of commitments cannot form the basis of an authorisation decision.

#### VIII. CONCLUSION

- (85) For the reasons outlined above, considered individually or together, the Commission issued a decision on 9 December 2004, which declared the proposed concentration incompatible with the common market pursuant to Article 8(3) of the ECMR in that it strengthens dominant positions in several gas and electricity markets in Portugal as a result of which effective competition would be significantly impeded in a substantial part of the common market.

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<sup>(15)</sup> The deadline for the submission of remedies was 17 November 2004.