

## How the European Energy Market Learned to Love EU Merger Controls

By Frank Schoneveld and Elena Kostadinova (McDermott Will & Emery/Stanbrook LLP)

Recently, the European Commission opened an in-depth investigation into the merger between Gaz de France (GDF) and Suez. Such investigations raise questions about the Commission's power to influence the liberalization of gas and electricity markets by approving or blocking mergers. It also highlights the debate about the commitments companies might offer in order to complete their intended transactions.

In June 2005, the Commission launched an inquiry to assess the competition conditions of the European gas and electricity markets. The Commission isolated five significant issues related to the energy market malfunctioning: high concentration in the gas and electricity markets; difficulties for new suppliers to enter the markets due to insufficient separation of infrastructure and supply functions; no significant cross-border competition due to insufficient interconnector capacity and long-term capacity reservations; lack of transparent market information to new entrants; and price formation not determined on the basis of effective competition. Under competition law, the Commission can intervene in antitrust, merger and state aid cases concerning the gas and electricity markets. Intervention by the Commission in merger cases is considered one of the most effective tools to achieve greater liberalization of the gas and electricity markets more quickly. In recent merger cases the European Commission has begun to establish relevant assessment criteria and more effective requirements to open the energy markets.

Merger control has proved to be an effective tool to ensure the proper functioning of the European gas and electricity market. This is because the on-going liberalization of the markets is accompanied by the restructuring of the incumbents, former national monopolies. In many cases the national incumbents are expanding into other EU Member States by acquiring the local incumbent operators or parts of their business. This is done to achieve advantages of scale when the current national markets grow into a true EU market. The Commission and the national competition authorities can exercise control over this process because they have to be notified of all important transactions and they must examine the impact of the transactions on competition. Failure to notify the European Commission can result in fines of up to 10 percent of the worldwide turnover.

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### **The Commission's Role**

The Commission examines the effects of the transaction on the relevant product and geographic markets. In previous cases the Commission identified eight distinct product markets: gas and electricity production; transmission; distribution; wholesale distribution; consumer supply; balancing market for electricity; storage for gas; and wholesale of gas to power plants. Competition rules apply to production, wholesale distribution and supply to industrial consumers, as well as access to the networks and storage for gas. The geographic market has in most cases been considered national, with the notable exception of the Nord Pool ASA market (Finland, North Norway and Sweden).

The Commission examines the current and potential future effects of the transaction on each of these markets. Such effects can be horizontal—for example, a gas company is considered to be a potential competitor in the electricity markets and a company active in the electricity sector can be a potential competitor in the gas markets. The vertical effects can be the ability to foreclose competitors in the downstream markets or in granting storage for gas. Other effects include when an electricity generator can obtain proprietary information about its competitors' costs or obtains access to gas resources. In its decisions, the Commission is influencing how the EU market develops by imposing conditions both on electricity and gas mergers and on the relationships between customers and suppliers. These conditions are designed not only to enhance competition, but also to enhance the regulatory framework established at an EU-wide level.

### **The Role of Business**

Businesses involved in these industries need to be prepared for the types of commitment they are likely to be required to make in order to have their acquisitions approved. The commitments demanded by the Commission can include ownership unbundling, gas release programs, contract release programs and access to infrastructure, storage and customers.

"Ownership unbundling" means part of the business must be sold to guarantee that, after closing the transaction, the companies will not align their positions in order to exclude other competitors.

In a "gas release program," the gas incumbent offers for sale certain quantities of gas from its overall sourcing

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portfolio. Purchasers then enter into supply contracts with the gas incumbent for these quantities.

In a "contract release program," the gas incumbent assigns part of its gas supply contracts with gas producers. Purchasers enter into a supply contract directly with the gas producers and the transferred gas supply contracts of the incumbent are terminated, or the gas quantities in the transferred supply contracts are reduced accordingly.

Both types of programs are designed to improve the liquidity of gas markets and enable competing traders and customers to acquire gas for their own use or for resale. These measures will not be successful if the competitors have no access to transmission or distribution capacities, or storage for gas. If one of the parties is an operator of such a network, the Commission will therefore impose conditions so that access to the network is available for competitors. The same applies to access to customers who are bound by long-term supply contracts. The Commission has imposed conditions so that customers should have the option to terminate their existing gas supply contracts or to reduce their obligation to purchase gas or electricity.

The merger between GDF and Suez will raise several issues. GDF is the incumbent gas operator in France, and is also active in Belgium. Suez is active in the gas and electricity sectors and in particular in Belgium via its subsidiaries Distrigas and Electrabel. In addition, Suez has recently entered the French markets in both gas and electricity. The Commission's investigation focuses on Belgium's gas and electricity markets and on France's gas markets but other national markets may also be analyzed. The Commission is likely to regard France and Belgium as separate geographic markets, and in this case the parties are likely to be required to make commitments to

eliminate competition concerns, or to divest part of their business along the supply chains in both the electricity and gas sectors. The parties may be required to commit to a gas release program, in order to allow other companies to enter the wholesale markets. There may be requirements to divest or allow their competitors access to their gas storage facilities.

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The European competition authorities' regulation of mergers can have a significant impact on the functioning of the European gas and electricity markets. This is mainly through the commitments that incumbents are forced to make in cases of change of control. These regulatory barriers must be taken into account when planning any merger or acquisition in the European energy market. The European Commission will almost certainly try to require commitments and divestiture of parts of the parties' business, not only to enhance current competition but also to enhance the success of the new regulatory environment which only now is coming into force throughout the European Union. Without careful planning, an apparently sweet deal may, following the Commission's intervention, leave a sour taste. □

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