Spain defies European Commission on energy company sell-off

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The €27 billion takeover bid by German energy giant EON for Spain's energy company Endesa has again brought Madrid into conflict with the European Commission. In a letter to the Spanish government on August 3, the European Commission raised serious concerns over 19 conditions that Spain's national energy commission (CNE) wants to impose on the deal, including the forced divestment of about 30 percent of the company's generating capacity. The European Commission accuses the Spanish government of seeking to "disguise interference with the flow of capital."

Spain has justified its actions by citing Article 21 of the European Union merger regulation, which allows member states to block takeovers on the grounds of "public security." Madrid rejects as "unfounded" the European Commission's doubts about the legality of the conditions imposed by the CNE.

The Socialist Party government has said it does not believe the EU will act further against the CNE's ruling. David Vegara, deputy finance minister, said, "We're not worried a procedure will be opened. We believe the ruling has a sound legal basis."

The bid is one of many that EON, the world's largest privately owned energy provider, has made in Europe in the last six years. In 2001, it bought the UK's Powergen and Sweden's Sykraft, and is now operating in new EU member countries Hungary and Poland and accession countries such as Romania and Bulgaria. EON also owns a natural gas company in Russia.

This latest takeover will turn the company into the world's biggest utility, with more than €75 billion in annual sales and at least 50 million customers, and will allow entry into Spain, Italy and France as well as Latin America.

The dispute erupted last September when another Spanish energy company—Barcelona-based Gas Natural—made a €22 billion bid for Endesa. The Spanish government welcomed Gas Natural's approach as an opportunity to create a national energy "champion."

The European Commission, on the other hand, saw the bid as anti-competitive and protectionist. It has no jurisdiction to stop it, but it did recommend that Spanish competition authorities review the deal because both companies were essentially nationally based.

The deal was eventually suspended in April by the Spanish Supreme Court, which noted other irregularities, including an agreement between Gas Natural and Iberdola, Endesa's main competitor in Spain, to divide up Endesa between them.

When EON came on the scene earlier in the year and outbid Gas Natural with its €27 billion offer, the Spanish government took the extraordinary step of passing a law widening the CNE's jurisdiction and giving it powers to veto deals that could affect strategic public interests. This immediately applied to the EON deal.

Endesa executives are reportedly unhappy with CNE's decision and have announced they will appeal it. While they have not publicly explained their reasons for this, according to the *Herald Tribune* many board members feel that the carving up of Endesa, per the regulator's ruling, will erode its shareholder value.

Endesa executives are also appealing against the Gas Natural bid. Ramon Trillo, head of the Spanish High Court's litigious administration branch, has indicated it may take up to two years to reach a decision, which will further complicate EON's bid.

The rejection of both bids by Endesa executives is no doubt an attempt to up the price and pave the way for higher individual payoffs. Apart from the amount, EON's bid is also more favourable because it is 100 percent cash, compared to Gas Natural's 30 percent cash, with the remainder in shares.

The EON management, in its turn, filed an appeal through the Spanish courts, saying, "We see no reason for the conditions, especially over divestments." However, CEO Wulf Bernostat more recently indicated the company was prepared to compromise, saying, "One could accept some of these conditions. We are most bothered by the forced sale of power stations and networks. It's more important to get it right than to get it fast."

Prime Minister José Zapatero has defended his government's position on energy, stating, "We support foreign investment.... In recent times, we have seen the arrival of important international companies—French, American. We only have one dispute regarding the energy sector, which we are very concerned about as a country."

When Volkswagen threatened earlier this year to relocate its Pamplona plant to Slovakia in an attempt to break the deadlock in negotiations for a new collective agreement that threatened workers' living standards, Zapatero kept silent. The Spanish ruling elite's indifference to the prospect of more than 4,000 workers losing their jobs was summed up by *El Pais*: "You cannot expect Spanish firms to extend their presence in other countries and apply an ancient protectionism in ours." Spanish companies spent more than €48 billion in acquiring foreign companies in the first half of this year.

Zapatero said the Spanish energy sector was a special case due to the country's dependence on energy imports and the fact that, apart from the UK, Spain is the only EU country without a state company participating in the European energy sector. This last point was a swipe at EON, which Zapatero implied was controlled by the German government.

Spain imports 99 percent of its gas supplies and 99.6 percent of its oil. In addition, oil and gas make up 70 percent of Spain's primary energy consumption, which is higher than the European average of 64 percent.

More than half of Spain's oil is imported from Mexico, Russia, Nigeria and Saudi Arabia, while Algeria accounts for 44.9 percent of its gas supply. Algeria is increasingly regarded as the only alternative gas supplier to Russia in Europe, which is why the recent deal struck by Russia's Gasprom in Algeria to further develop the country's gas sector was of great concern in Spain.

Zapatero's position is also closely tied to concerns over wider problems facing the Spanish economy. While Spain's economy is expected to grow this year by around 3.5 percent, double the European average, an adverse consequence has been a rise in inflation to 3.9 percent—up from 3.1 per cent a year ago. This in turn is eating away at Spain's global competitiveness, which is reflected in a 37 percent increase in the current account deficit in the first quarter of this year.

Thus far, energy prices in Spain have risen only moderately. In 2005, electricity prices for Spanish industrial consumers went up by 5 percent, compared to the EU's 16 percent. But the investment bank BNP Paribas has pointed out "the impact of changes in oil prices on headline inflation has been more accentuated in Spain than in most European countries due to its higher energy dependency," which can be attributed largely to Spain's booming construction sector, which makes up around 17 percent of GDP.

A recent article in the British *Economist* magazine explained, "Mr. Zapatero has little room for maneuver [with regard to curbing inflation]. He cannot devalue a currency, the euro that is shared with 11 other countries. He cannot look to a sharp rise in interest rates to curb inflation because rates are set by the European Central Bank, which must take into account the larger, more sluggish economies of Germany and France."

However, the *Financial Times* has likened the Spanish government's stance to "the guerilla warfare that Spaniards invented against Napoleonic invaders," and urged European Commission Competition Commissioner Neelie Kroes to meet the challenge of protectionism "if the EU single market is to mean anything in energy or any other market."

This reflects fears in European ruling circles that unless EU energy policy is decided on a collective basis, the continent will be even more vulnerable to prices being determined by external suppliers. This was brought home at the beginning of the year when Russia's dispute with Ukraine over energy prices resulted in fuel shortages across much of Europe.

Kroes has reassured her critics, saying, "Personally, I very much welcome the moves towards full structural unbundling [separation of the supply and retail businesses] that have been made in a couple of member states. I believe that this will allow a more efficient market, with an improved incentive structure, to develop. Regulation can then also be made less complex and more effective. Should the functioning of the market remain unsatisfactory, this is certainly an option we will have to consider carefully at EU level."

Earlier this year, the European Commission sent a formal notice to 17 member states stating its intention to ensure that internal markets conform to the relevant legislation. Andris Piebalgs, the commissioner with special responsibility for energy, stressed, "The member states must implement the directives on gas and electricity quickly and in full, not only in form but also in substance. Having carried out a detailed examination, the Commission has decided to launch a large number of infringement procedures against member states which have not applied these rules or other measures which are essential to achieve a high level of growth and competitiveness in Europe."

However, the European Commission is restricted in the action it can take against individual members. Thus, while stressing the need for a common energy policy, the EU's energy Green Paper published in March was forced to concede that although "it is essential to act in an integrated way...each member state will make choices based on its own national preferences."

In this regard, the Endesa dispute is by no means unique. Rising oil prices and the threat of higher inflation as a whole have led to similar actions in other countries. Earlier this year, for example, a last-minute merger was arranged between French companies Gaz de France and Suez in the face of a possible bid by Italy's Enel, while in Austria, OMV and the national utility Verbund have agreed to merge.

This points to the inability of Brussels to provide a European solution to the energy problem, which will only stimulate protectionism as individual members seek to resolve the question within their own national borders.