Tense takeover battle for Spain’s Endesa energy company

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31 October 2006

The longstanding dispute over the takeover of Spanish energy company Endesa exploded again last week, after the European Commission sent the Spanish government a formal notice over the latter’s refusal to lift the conditions it imposed on the €27 billion takeover bid by German energy giant EON. A successful bid by EON, the world’s largest privately owned energy provider, would turn the company into the world’s biggest utility and allow it access through Endesa into Spain, Italy, France and Latin America.

The formal notice was the result of the EC’s verdict at the end of September that the Spanish government’s actions were an attempt to “disguise interference with the flow of capital” and illegal under EU anti-trust legislation. Madrid must comply or face court proceedings.

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.” Prime Minister José Zapatero has stated, “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.”

Spanish companies have been some of the most prolific in foreign hostile takeovers in the last few years, with more than €48 billion spent in the first half of 2006 in foreign acquisitions.

The energy question is of particular importance to Spain, which imports 99 percent of its gas supplies and 99.6 percent of its oil. Oil and gas make up 70 percent of Spain’s primary energy consumption, higher than the European average of 64 percent. Spain has a higher energy dependency than most European countries mainly due to the construction industry, which makes up 17 percent of Spain’s GDP.

Energy minister Joan Clos admitted that the EC’s action took Madrid by surprise and said, “We are going to play within the framework of Europe because we must do so and can not do anything else . . . we must make an effort to do this as soon as possible.”

Behind the EON dispute lie the growing tensions between Spain and Germany. Access to energy sources has become an issue of vital strategic importance for European ruling elites and an increasing source of rivalry between them. China’s growing energy needs and the war in Iraq have already contributed to rising prices, while future conflicts will inevitably lead to supply shortages.

The dispute arose earlier this year when Spain’s national energy commission tried to impose a number of conditions on the EON deal, including the forced divestment of about 30 percent of the company’s generating capacity. The move was designed to support a rival €22 billion bid from Spanish Gas Natural and bolster the Spanish government’s plans to create a “national energy champion.”

At the end of September, one day before the EC announced its verdict, the Spanish construction company Acciona took the market by surprise when it bought 10 percent of Endesa’s stock for €3.3 billion. In the weeks that followed Acciona enlisted Banco Santander to provide the financing for a further 8.5 percent purchase and has the option to buy up to a further 10 percent.

Acciona has said that its intention is to purchase just under 25 percent of Endesa’s shares, which under Spanish law would not require it to launch a formal takeover bid. When the Spanish government declared that it intended to raise the threshold to 30 percent, Acciona announced it would consider increasing its stake to just under 30 percent.

All signs suggest these maneuvers are part of a conscious effort to disrupt EON’s bid. London journal *The Business* points to the possibility of “government officials nudging their friends in industry to block foreign firms from dominating Spain’s energy sector.”

According to analysts, Acciona’s tactics are to muster enough voting rights to prevent EON persuading other shareholders to overturn a condition in Endesa’s constitution, which prevents any one party from owning more than 10 percent of the stock. This is necessary for the completion of EON’s bid, whose goal is to obtain control at least 50 percent of the voting rights.

EON’s initial response to Acciona was to increase its bid by 40 percent to €37 billion and launch court proceedings in New York where both companies are listed. A spokesman for EON said, “The aim of the court action is to get Acciona to rectify its proceedings and to prevent further share purchases (in Endesa). We see Acciona’s action as violating US stock market regulations.” Acciona denies the claims and a New York court ruled in its favour last week, with a further hearing scheduled for November.

Although Acciona’s action relating to Endesa are being carried out on behalf of Spain’s ruling elite anxious to protect its sources of energy, its also represents a trend amongst construction companies that are looking to invest the wealth accumulated in the decade long building boom that is now coming to an end. Last month construction giant ACS, which already owns 35 percent of Union Fenosa, made a €3.4 billion bid to buy a 10 percent stake in Iberdrola with a view of orchestrating a merger, which would create Spain’s biggest energy company with a market value of €42 billion.

The energy sector reaped €5.3 billion in profits last year, which is €3.2 billion more than the construction sector and has therefore proved an attractive prospect. According to Juan Ignacio Sanz, a law professor at Spain’s ESADE business school, construction firms investing in energy provides them with “diversification, anticipation of a change in the construction and real estate businesses; a greater desire to generate added value and also get into a business that has attractive growth rates in the future and where prices will surely have to be raised, even if only a bit."

The speculative fever around the EON takeover has also been fuelled by Endesa's third quarter profit figures, which were up by 25 percent. Endesa's net profits have increased 60 percent over the last nine months to €2.5 billion and are projected to grow to €3 billion by 2009. Much of the increase has been attributed to its recently acquired Latin American operations.

EON CEO Wulf H. Bernotat made assurances earlier in the year that there would be no redundancies as a result of the takeover. General Secretary Cándido Méndez of the energy workers' union FIA-UGT responded that there would be redundancies and that the takeover would result in a reduction in investment and higher prices for consumers.

The union's nationalist response to the dispute has been to urge the government to take a stronger stand to protect Endesa. At the same time it has called on Spain's Ministry of Industry, Tourism, and Commerce to set up an immediate roundtable where "all stakeholders, together with the government, analyse, define and agree on a model of consolidation for the energy sector that reflects the interests of Spain"—a well worn method of preventing opposition amongst workers from developing.

Meanwhile the government is under intense pressure to lift the cap on electricity prices that helped keep the rise in prices for Spanish industrial consumers in 2005 down to five percent, compared to the EU's average of 16 percent. Not that the energy companies suffered—a royal decree in June this year ruled that the government will make good the 2005 rate shortfall that resulted from the government-imposed cap on prices with a handout of almost €4 billion payable over 15 years.

The Spanish government has confirmed that regulated rates on energy prices for industry will end by 2011. In anticipation of this, Spain's industrial energy consumer group AEGE has reportedly been discussing with leading suppliers the possibility of a 20 year bilateral agreement. Preferential treatment for industrialists in case of price rises means that higher energy costs will ultimately be passed on to the Spanish working class, which has seen wages stagnate and accommodation costs double in real terms during Spain's decade-long economic boom.

From the energy companies' perspective the freedom to realize increased profits from higher oil prices free from government restriction is vital. Recent takeovers by energy companies have created massive levels of debt, which need high steady cash flows to be serviced and which have led to a marked deterioration in investors' perception of Endesa's creditworthiness.

At the end of 2005 Endesa had the second largest debt level of all energy companies in Europe, attributed mainly to its acquisition spree in Latin America. Endesa has already taken steps to reduce its debt level by selling off its portion of the rate shortfall it is due from the government to a consortium of banks. For its part EON plans to finance Endesa's takeover with a €37 billion loan—one of the biggest ever raised.

Recent developments have underscored the inability of the EU to come up with a common energy policy for Europe. In a Russia-EU summit this month, Europe failed to gain a commitment from Russia to open up its domestic market. Europe relies for 25 percent of its energy needs on Russia, which resulted in fuel shortages across Europe earlier in the year as a result of Moscow's dispute with Ukraine over gas prices. This has caused much concern among the ruling elites of Europe, which has highlighted the need to integrate Europe's energy policy.

However, in contrast to the "hard-line" position the EC took against Spain over its restriction on EON's bid on Endesa, no formal action has been taken against the more economically powerful Germany. Berlin had imposed a golden share condition on EON's takeover of Ruhrgas in 2002—strikingly similar to the action taken by Madrid. It was only after a string of complaints from other member states, Spain included, that the EC decided to take any action at all. It was only last week that Charlie McCreevy, the internal market commissioner, wrote a letter to German authorities demanding that they justify the conditions, which amounts to no more than a slap on the wrist.

Far from providing the framework for an integrated energy policy, the EU bureaucracy acts as nothing more than an arbitrator between the conflicting national interests of member states with powerful countries like Germany usually coming out on top.

EON's bid for Endesa is in pursuit of the essential interests of the German ruling class, which wants to reduce Germany's excessive reliance on Russian energy supplies. Currently 43 percent of its natural gas, 34 percent of its oil and 16 percent of its deep-mined coal comes from Russia. In contrast, Spain gets almost half its gas supplies from Algeria, which has been cited as Europe's only other viable alternative gas supplier.

Germany's ambitions have created concerns among other member states. It is these concerns which have prompted the EC to bring forward plans for next year to further liberalise Europe's energy market, including the "unbundling" of companies like EON and France's EDF, whose ownership of supply networks is seen as stifling competition.

According to the Competition Commissioner Neelie Kroes, "Network companies should not favour their own distribution or generation companies, at the expense of independent companies." This has done little to convince the German government, which has openly expressed doubts about the plans, as it has about a separate idea by EU President José Manuel Barroso to toughen energy regulation on a European level.

The EU's position is perhaps best summed in a Green Paper published in March which 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."