CNC
COMISIÓN NACIONAL DE LA COMPETENCIA

SUMMARY OF THE REPORT-PROPOSAL IN THE SECOND PHASE CASE C/0098/08 GAS NATURAL / UNIÓN FENOSA

I.- Nature of the operation and companies

The operation involves the acquisition by GAS NATURAL SDG, S.A. (GN) of exclusive control of UNIÓN FENOSA, S.A. (UF). The concentration does not fall within the scope of application of Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings, because even though they exceed the article 1 thresholds, both GN and UF obtain more than two-thirds of their Community-wide turnover within Spain.

The undertakings involved in the operation are two publicly traded vertically integrated energy companies. GN is the parent company of an energy group whose primary business is the supply, transportation, distribution and marketing of gas and in generating and selling electricity. GN owns 5% of the share capital of Enagás. GN, in turn, is jointly controlled by Repsol YPF, S.A. and Caja de Ahorros y Pensiones de Barcelona.[1]

UF primarily operates in the electricity sector (generation, distribution and marketing), although in recent years it has also entered gas markets, mainly the joint venture, Unión Fenosa Gas, S.A., which it owns 50-50 with ENI, S.p.A. UF has an 5% equity holding in Cepsa (and names one of the 19 members of its Board) and a 1% stake in Red Eléctrica de España. It also has a holding in the gas distribution company Gas Directo, S.A. (60%), together with Cepsa (40%).

II. Relevant markets and their analysis

In line with the domestic[2] and Community[3] precedents, natural gas and electricity are considered to be different product markets given their scarce substitutability on both the demand and supply side.

II.1. Gas sector

II.1.1. Gas exploration and production market

The gas exploration and production market consists of the exploration, development and exploitation of natural gas fields. Geographically, it takes in at least the European Economic Area (EEA), Russia and Algeria. The parties' business in this market is marginal (their aggregate EEA-wide share is less than 1%, although the merged entity would account for 100% of gas production in Spain).

[1] Both parent companies have voting rights in the adoption of the company's strategic decisions.
[2] See, inter alia, Report TDC C-94/05 GAS NATURAL/ENDESA.
[3] See, inter alia, cases M.4180 GDF/SUEZ, M.3696 E.ON/MOL, M.3440 ENI/EDP/GDP.

II.1.2. Gas supply market in Spain

This market comprises the wholesale activities by which a wholesale gas operator meets the demand for gas in the Spanish market. In geographical terms, it includes at least the EEA and the natural gas producing countries of the Mediterranean and Atlantic basins.

The parties had a combined market share in Spain of 63% in 2007. GN's position as number one gas supplier in Spain is strengthened, given that in 2007 GN formally brought in [50-60]% and UF [10-20]% of the gas consumed in the Spanish system.

II.1.3. Short-term or "flexibility" secondary wholesale gas market.

This market includes over-the-counter (OTC) transactions carried on by the various gas suppliers in Spain to trade gas with each other. It is mainly a tool for allowing flexibility in the supply of liquefied natural gas in Spain. The geographical scope of this market is Spain.

The combined share in 2007 of the MS-ATR platform (which records the transactions carried out in Spain) was 26% (addition of 15%) and the merged entity will consolidated its position as the number one operator in this market.

II.1.4. Import and transport infrastructure

This market includes the infrastructure for the basic gas network, in particular, infrastructure for imports (international gas pipelines and regasification terminals), storage (deposits underground and in regasification terminals) and the basic high-pressure gas transportation network (primary network, with pressure of more than 60 bars, and secondary network with pressure of more than 16bars). In general, irrespective of who owns the network, access to these infrastructures is regulated and supervised by Enagás.[4]

In June 2008 there were 13 compression stations, owned by Enagás, and more than 8,500 km of gas pipeline, approximately 90% of which are owned by Enagás (8,364 km), with GN having 578 km.

II.1.5. Gas distribution networks

This market includes the gas distribution networks that run from the high-pressure transport network to the end consumer (at pressure of 16 bars or more, unless they are dedicated to a single consumer). Each distribution network is a natural monopoly, such that both the terms of accessing them and prices are regulated. In geographical terms, it is a regional market delimited by the area covered by the pertinent administrative authorisations.

[4] Enagás is the technical manager of the system and the principal operator of the important and transport infrastructure in Spain, although not the only one. Its purpose is to ensure the continuity and security of gas supply in Spain and proper coordination between the access, storage, transport and distribution points.

GN has a particularly large share of this market (84%), whereas UF's is 0.1%. UF only operates in the provinces of Madrid, La Coruña, Ciudad Real and Sevilla. In all of them GN is the only alternative gas distributor[5].

II.1.6. Retail gas supply markets

A distinction is made between supply to large customers (treated like the high-pressure supply), supply to households and small and medium enterprises (treated like low-pressure) and supply to combined cycle plants. This market is national in scope.[6]

In the market for supply to combined cycle plants, most of the companies are vertically integrated and make supplies to their own combined cycle units. In 2008 the merged entity supplied gas to combined cycle plants that accounted for [50-60%] of the generating capacity of combined cycle plants in Spain (addition of [10-20] points). In gas supply to large customers, the combined market share in 2007 was [50-60%] in terms of energy and [60-70%] in customers (addition of [0-10%]), much greater than the second leading operator, Endesa ([10-20%]). As for low-pressure supply, the combined share in 2007 was [70-80%] in energy and customers (addition of [0-10%]). There is a strong correlation between the GN distribution networks and its customers in the unregulated market.

II.2. Electricity sector

II.2.1. Wholesale power production market

The wholesale power production market includes the electricity exchanges that take place at the wholesale level, and which determine the market price and the operating level of the various power plants. In geographical terms the market is defined as the national mainland market.

The combined market share in power production in 2008 was [10-20%] (addition of [10-20%]), for the third spot in the ranking after Endesa and Iberdrola, which have shares in the [20-30%] range.

II.2.2. Market for resolution of technical restrictions

Technical restrictions stem from limitations in the transport network that make it non-viable to execute the programming of generating units as determined by the daily market and are managed by the system operator. The geographical scope of this market is defined as a function of the zone affected by the restriction, local or regional, because the restriction can normally only be resolved by the plants closest to the point where it occurs.

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[5] Similarly, in the provinces where UF is present in electricity distribution, GN has a monopoly or quasi-monopoly over the gas distribution networks, except in Badajoz, Valladolid, Toledo, Salamanca and Segovia.

[6] There is no supply of gas natural to end customers in the Canary Islands, and on the Balearic Isles the supply is of propane gas.

The operation strengthens the merged company in the Campo de Gibraltar area where the combined production market share was [30-40%] in 2008 (addition of [10-20%]), ranking it second behind Iberdrola. In addition, the concentration also implies the acquisition of UF's position in the zones of Huelva, Levante North, Centre and Galicia North.

II.2.3. Electricity distribution networks

Electricity distribution is a regulated activity (since it is a natural monopoly) that comprises all activities entailed by the delivery of energy from the high-voltage transmission network to the end consumers. These are local or regional markets.

The merged entity acquires the UF networks, which are present in 19 Spanish provinces, with the addition being only marginal (less than 1%) in the province of Salamanca.

II.2.4. Retail supply of electricity

This supply consists of delivery of energy from the transmission and distribution networks for economic payment. In Spain this supply can be contracted at a regulated tariff with a distributor or at an unregulated price.[7] A distinction is made between supply to large customers (high voltage) and to households and SMEs (low voltage) and the geographical scope is national.

The merged company is marginally strengthened as third ranked operator after Endesa and Iberdrola, with a share of this market in 2007 of close to [10-20%] (energy) and [10-20%] (customers). The combined share both in high and low voltage was [10-20%] (addition of [10-20%]).

II.3. Barriers to entry

In the **natural gas** sector significant entry barriers have been identified, including availability of gas supply sources, lack of flexibility of the gas supply system in Spain, the need to attain efficient minimum scales and vertical integration of distribution and supply networks.

Important barriers are also detected in the **electricity** sector, such as the scarce capacity of the Spanish power system for interconnection with other electricity systems, the existence of strategic assets, the costs of installing and diversifying generating facilities and the vertical integration of generation and supply and distribution and marketing in the principal operators.

III. Assessment of the operation

In the **gas sector**, GN wields significant market power, mainly as a result of its strong position in the supply of gas into Spain, its large shares of the various markets for supply to end customers, its vertical integration and its structural and commercial ties to

[7] When the decision was made, it was projected that the regulated market would be confined to small consumers (supplier of last resort), and that this activity would be carried on by tariff traders, subject to maximum prices (last resort tariff). The last resort supply system is currently in force.

its main competitors. This market power will be strengthened by the operation even though in recent years factors such as the increase in regasification capacity and regulatory unbundling of the distribution network from supply have helped facilitate competition.

The concentration is deemed capable of hindering competition in the supply of gas to Spain as it buttresses GN's leadership. Furthermore, the disappearance of UF as an independent competitor is especially important given its vertical integration, its alliance with ENI and its supplyside independence from GN.

With respect to the secondary gas wholesale market, the concentration may aggravate the Spanish gas system's lack of the flexibility, because GN will become the most important entity offering flexibility and UF disappears as an independent operator, which is important because it has a much larger presence in this market than in retail supply.

Also, although the resulting entity is strengthened only marginally in the import and transport infrastructure market, this factor is salient for analysing the strategic value of the ties between GN and Enagás.

In gas distribution networks, GN becomes the only operator in this market in certain provinces, although with only minor additions. This could reduce effective competition in the rolling out of new networks, given the legal preference for the granting of new networks to the closest distributor.

In relation to the supply of gas to end customers, the merged entity strengthens GN's position as top supplier in Spain. This strengthening is less worrisome in the supply to combined cycle plants and to large customers due to the existence of factors such as self-supply of combined cycle facilities and the expected entry of new operators, the greater trend toward effective competition in the high-voltage market and the coming on line of the Medgaz gas pipeline. However, in the supply of gas to small customers, the operation diminishes effective competition because the operator that disappears has significant growth potential given its presence in power distribution and supply and its vertical integration in the gas sector. In addition, it partly offsets the loss of market share recorded by GN in recent years in a market with a small number of supplyside players (give, which would become four).

With respect to the **electricity sector**, GN is the agent whose entry in the power production wholesale market has been the most successful and sustainable in recent years, in large part to due to the availability in enjoys of natural gas as fuel for combined cycle facilities and to the fact that its scheme of incentives is different than that of the incumbents.

In electricity production, the new group would stand at the level of the dominant operators Endesa and Iberdrola albeit with a smaller share of this wholesale market, thereby intensifying the level of concentration of the market. Although the operation is not considered to carry a significant risk of having a unilateral effect on this market, it does increase the risk of coordination between the new entity, Endesa and Iberdrola, as it expands not just the capacity, but also the incentives for coordination.

The increased strength of the resulting company in supply to end customers is compounded by the incentives for the new entity to continue growing in those markets, given that is share is higher in the generating market than in retail supply. Nevertheless, as a result of the operation, there is a strengthening of the merged company's **simultaneous presence in gas and electricity networks**, which creates a risk to the maintenance of effective competition in the retail supply of gas and electricity to residential customers and SMEs.

In summary, given the structure of the market after the operation and the existing barriers to entry, in the absence of certain commitments or conditions, the operation is considered capable of generating risks for the maintenance of effective competition in some of the markets considered, especially in the supply of gas to Spain, the wholesale electricity market and retail supply of gas and electricity.

IV. Commitments and assessment

GN submitted the following disinvestment **commitments**:

-Disposal of 600,000 gas distribution points, primarily in the provinces where there is overlap between the GN and UF networks.

-Disposal of the business associated with natural gas customers (approximately 600,000). GN likewise undertakes to supply buyers with the natural gas needed to meet the requirements of those customers during two years in market conditions.

-Disposal of 2,000 MW of power generating capacity with combined cycle technology currently in operation with a remaining useful life of not less than 10 years, located in Andalusia, Galicia, Centro, Levante and Catalonia. GN also undertakes to supply the buyer with natural gas to satisfy its supply needs during two years in market conditions.

-Sale of GN's interest in ENAGÁS (and waiver of naming a representative on the ENAGÁS Board of Directors).

GN undertakes to transfer these assets in a confidential timeframe to a buyer that does not generate risks of hindering effective competition and is approved by the CNC.

Another commitment proposed by GN was to remove the Director it appointed on the CEPSA Board and, for so long as the REPSOL interest in GN is more than 15%, it will not nominate Directors on the CEPSA Board, nor request confidential commercial or industrial information from CEPSA, and it will ensure that REPSOL does not have access to confidential commercial or industrial information of the CEPSA petrochemical complex in San Roque. GN also offered a commitment to present monthly compliance reports to the CNC and a detailed plan of actions. And lastly, it submitted certain commitments that were declared confidential in relation to Unión Fenosa Gas Comercializadora.

These commitments are considered **suitable, sufficient and proportionate** for eliminating the obstacles to competition arising from the operation in the various markets. In this regard, the disposal of the gas distribution points and customers will allow greater competition in the supply of gas to small customers (in which there are greater entry barriers), as its numbers for distribution points and customers are larger than those of UF. With respect to the disinvestment in combined cycle plants, it will contribute to offsetting not just the horizontal effect of aggregating market share in generation**,** but also to the vertical strengthening between gas supply and power generation. The technology is appropriate because it is the withdrawable technology that ordinarily sets the electricity price. Its location is also adequate because it coincides with the areas of technical restrictions where the greatest risks to competition have been identified. And the commitments regarding Cepsa and Enagás mitigate the risks derived from the creation or strengthening of structural ties.