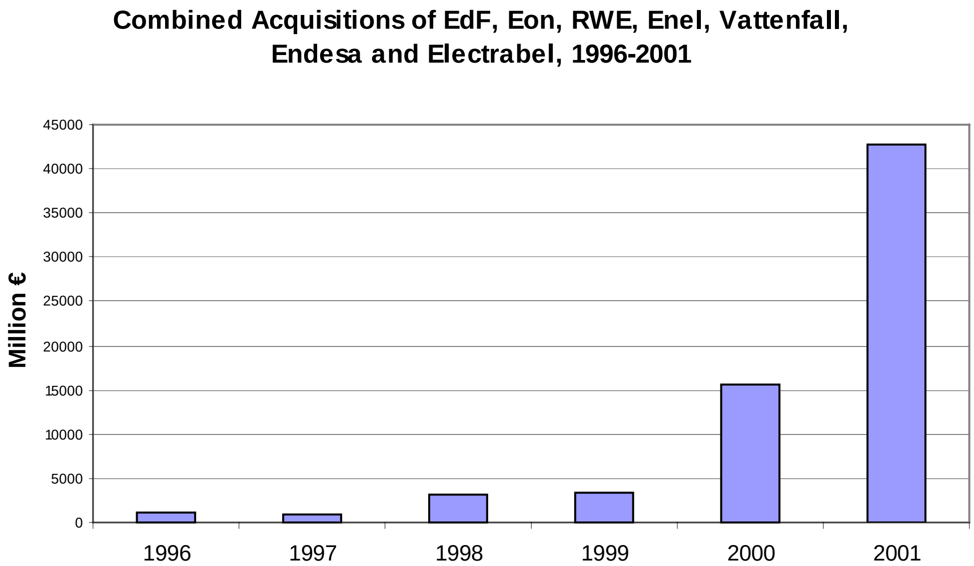
Market Concentration in the Power Sector

May 2002

"Without stricter rules on market dominance and a phase out of the existing market distortions in favour of some big players, the European electricity market will be dominated by a handful of oligopolies. This is a threat to the functioning of the market and the democratic control of a vital public service", Claude Turmes, rapporteur of European Parliament for the directive on liberalisation of the electricity.[1]

The EU market liberalisation directive was introduced to increase competition in three main areas: Electricity Grid – although it tends to be a natural monopoly-; generation; and trading and sales. Over recent years however, we have seen the merging and take-overs of companies, resulting in the concentration of the market to a small number of companies. This concentration dynamic has reached a dramatic level during the last two years, as can be seen in the graph below, with acquisitions rising from €3.5 billion to €42 billion, a 12 fold increase.



Source: EdF 2002

The avoidance of market dominance is of particular importance in this sector as electricity cannot be stored and the potential to exercise market power is much greater than in other commodities. The importance of this phenomena has been highlighted during the crises in California, but also through the manipulation of the electricity prices in the UK pool and recently on the German power exchange. The market dominance is most threatening on the generation side where different developments can be observed:

- In certain countries - France, Greece - the market for electricity generation has not been opened and the historical operators dominate these markets.
- In the countries that have seen market opening, political pressure on national merger authorities has weakened mergers control and has allowed market dominance. This is the case notably in Germany and Spain

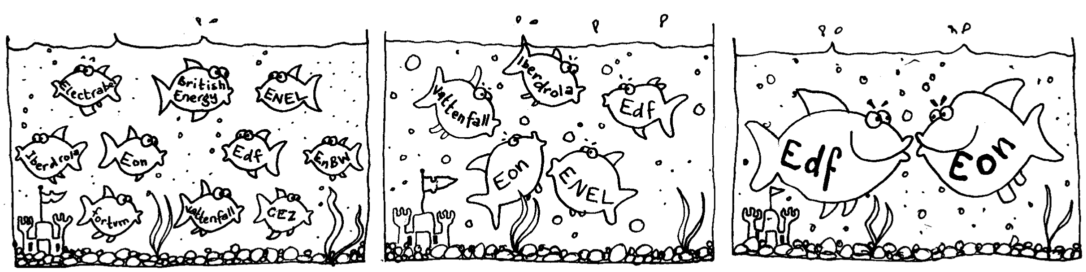
[1] For further information visit http://www.Eu-Energy.com/electricity and click on Debate in the EU

- In the UK and Scandinavia the liberalisation of the market was most complete and this has resulted initially in an increase in competition, for example in the UK there was an increase in major generators from 11 to 33 from 1991-2001. However, as many of these companies have been bought by European utilities, it is adding to market concentration on a European level.

The EU Commission is not addressing important economic market distortions in the emerging EU market like the access to decommissioning funds[2] where some companies have access to enormous resources to build up an aggressive acquisition policy in other countries. This is notably the case for EdF, E.ON and RWE.

The weakness of today's EU merger control in this area is illustrated by the fact that the EU had no say in EdF buying Dalkia, an industrial co-generation company and its main competitor in France. Even a 'mega-fusion' like the one proposed between E.on and Ruhrgas or similar mergers between Spanish electricity producers does not fall under the current EU competition law.

The EU has to act quickly or it will be too late to prevent oligopolies. Electricity is unlike many other commodities in that it is difficult to store. Consequently, it is easier for dominant players to manipulate the market at key times to significantly alter the price of electricity. Furthermore, even higher levels of dominance are expected in the 'balancing' market where even fewer companies are active. With this in mind, the revised Directive proposes to review market concentration, but clearer guidelines are required. Specifically, the regulator should monitor market concentration trends, make recommendations to the Parliament and advise Monopolies and Mergers Committees on developments in the Electricity Sector. Furthermore, the Commission should develop specific requirements about market concentration. As a start the Commission and Council should take four clear steps to reduce the impact on the market of increased concentration, these are[3]:-
1) Strict unbundling of generation, transmission and distribution, as a first step with legal unbundling leading in the near future to full ownership separation.
2) Across the EU there must be common rules and charges for use of networks. These rules must be fair, transparent and of a binding nature.
3) Decentralised power generation is important for balancing of the grid and increasing security of supply and should receive a premium for long term avoided network costs.
4) The additional market distortions, such as use of decommissioning funds in market acquisitions should be removed.



Big fish, small pond

[2] For more information visit http://www.Eu-Energy.com/electricity
[3] Conclusions from the report, Power Generation Market Concentration in Europe 1996-2000. An Empirical Analysis, Öko Institute e.V., May 2002.

The dominant European electricity companies are shown in the following table. Within this group, more large-scale mergers and acquisitions are imminent, further increasing the dominance of a handful of companies.

Company	**Nationality**	**Percentage of EU Market**	**Owned By**	**Key Strategic Ownership**
EdF	France	17	100% State Owned	ASA – Austria: Dalkia (France) ; Edison; Italenergia; London Electric; EnBW
RWE	Germany	9.7	Private	Innogy
Eon	Germany	9.0	Private	Bayernwerk: Preussen Elektra: VEAG Sydkraft, Power Gen
ENEL	Italy	8.0	100% State Owned	Elcogas (Spain)
Vattenfall	Sweden	5.0	100% State Owned	HEW,VEAG, Laubag, Bewag (Germany); Finish and Baltic States
Electrabel	Belgium	2.7	Tractebel (40%) Communes (5%) Tractebel Suez	Hidrocantabrico (Spain) ; Belgo-Nucleaire ; Epon (Netherlands)
Endesa	Spain	2.6	Private	Enersis; NRE (Netherlands)SNET (France)
British Energy	UK	2.6	Private	Active in US market, Exelon
Iberdrola	Spain	2.3	Private 2% EdP	Enipower (Italy) : Iberdrola-Tractobel
EnBW	Germany	2.0	EdF part owned	Hidrocantábrico
CEZ	Czech Republic	1.8	100% State owned	None
Fortum	Finland	1.8	50% state owned	IVO : Neste : Gasum

Furthermore, there is also an increasing trend of diversification by utility companies. European multi-utilities are now developing which provide energy, water, waste and telecommunication services. The table below shows how far this has occurred.

	Energy	Water	Waste	Communications
Suez	X	X	X	X
Vivandi	X	X	X	X
RWE	X	X	X	X
Eon	X	X	X	X
EdF	X		X	
Endesa	X			X
ENEL	X	X		X

Across Europe the trend of market concentration is set to continue. National regulators appear reluctant to act against market dominance in their domestic market as they wish to ensure a strong and large domestic utility exist, which is able to compete and survive in the European market. Consequently, it is forecast that within a few years a handful of companies will dominate the market. This is a threat to the functioning of the market and the democratic control of a vital public service. It is therefore essential that controls are put in place to ensure that mergers and acquisitions are carefully scrutinised and if necessary controlled.