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Electricity Merger Control in the Light of the EU "Third Energy Package"
by J. Velasco Fernández

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JORGE VELASCO FERNÁNDEZ

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Electricity merger control in the light of the EU “Third energy package”

By Jorge Velasco Fernández*

1. Introduction

After more than two years of legislative proceedings within the European Union Institutions, the so-called “third energy package” –a set of legislations conceived to lead the EU electricity and gas markets to a complete integration and liberalization - was published on August 2009.

The legislation, which is composed of two directives and three regulations[1] - principally dealing with conditions for access to gas and electric transmission networks, cooperation between energy regulators and the introduction of the appropriate rules for the completion of the internal market for electricity and gas[2]- aims at reaching global EU energy objectives such as the access to broader consumer choice, fairer electricity and gas prices, cleaner sources of energy and security of supply.[3]

Nonetheless, the set of legislations was not passed without long discussions on some of its cornerstones. Particularly, when it comes to the separation of the generation

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[1] As it occurs in other fields of competence of the EU, the European Institutions have resorted -within the framework of the liberalization of the energy markets- to a mix of different legal instruments to crystallize their objectives. The European directives –that are binding for the Member States when it comes to the objectives to be achieved but, unlike the European regulations, leave the countries the choice of the form and method to do so- have frequently prevailed, allowing each Member State to select the legal tools best suited to reach the opening of the markets according to the particular features of each national energy landscape.

[2] That is to say, the completion of one single efficient European market instead of 27 different national markets.

[3] Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing directive 2003/54/EC.

and supply activities from the network operations in the electricity markets –a key factor of the liberalization process-, the European Commission supported from the very beginning, and throughout the legislative procedure, the ownership unbundling option.[4]

Notwithstanding this, and principally due to the strong pressure inflicted by some Member States[5], a watered down version of the separation of functions was finally approved by the European Parliament and European Council. Accordingly, countries in the EU were given the option to choose less intrusive alternative in terms of property disaggregation.[6]

Against this backdrop, the EU merger control applied by the Directorate General for Competition of the European Commission (DG Competition), which has been playing a role in the liberalization process of the electricity markets as a kind of "ex-ante" supervisor, faces new challenges. In the light of the goals set by the new EU energy legislation and the tools that, on the regulatory front, have been provided to the European Commission, one might wonder whether the EU merger control enforcement

[4] The outright ownership separation of the transmission activities –a stage of the electric power industry commonly viewed as a natural monopoly- from the generation and supply stages –considered as areas where competition rules might efficiently apply- is the strictest solution to address discriminatory access conditions applied by the companies that have traditionally provided electric services. It should be noted that other softer alternatives that deal with the separation of functions -required to make competition thrive in the generation and supply segments- have been applied in different jurisdictions.

Numerous authors have written abundantly about the essence and main characteristics of natural monopolies as well as the evolution of some of the stages that constitute the electric power industry towards a more competitive environment. References to this concept are found in a broad array of publications (from the "Principles of Political Economy", where John Stuart Mill introduced the term of Natural Monopoly for the first time, to more recent publications specifically related to the electricity field. See PETER Z. GROSSMAN AND DANIEL H. COLE, THE END OF A NATURAL MONOPOLY: DEREGULATION AND COMPETITION IN THE ELECTRIC POWER INDUSTRY (Taylor & Francis Ltd., 2003)).

With regard to the European Commission support to the ownership separation, see, amongst others, speech of Philip Lowe, former Director General of DG Competition, Can EU competition policy create competition in the energy sector? 8-9 (Nov. 6, 2008) (transcript available at the European Commission website http://ec.europa.eu/competition/speeches/text/sp2008_09_en.pdf).

[5] Some EU countries were concerned about the possibility that the unbundling measures weakened the European Union suppliers (reducing the economies of scale and increasing the cost of capital of the supply business by forcing these companies to unbundle); as a result, according to those Member States, the security of supply could be put in jeopardy. Uneasiness about potential market entries of "foreign" operators like Gazprom in the EU energy markets were probably behind those arguments though.

[6] When it comes to the different options for the unbundling of activities in the electricity field, see directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54.

will have to be reviewed when analyzing merger operations in the electricity markets.

The high degree of complexity of enforcing merger control in any jurisdiction is not novel, particularly when different authorities are responsible for gauging the competitive and anticompetitive effects arising from merger operations. As it will be noted in this paper, that endeavor results even thornier in the electricity sector, where the relevant competition authorities have to simultaneously deal with the strengths and weaknesses of regulatory and antitrust approaches.

In this context, the role that the EU merger regulation should play in the liberalization process arena is indeed controversial. Conflicting opinions about that role have arisen as a result of the decisions undertaken by the DG Competition in this field within the last years. Thus, in some cases the Directorate General for Competition has been criticized for its application of a too-relaxed standard when analyzing mergers in the electricity markets.[7] On the opposite end, incumbents –but also some Member States- frequently argue that a too strict application of the merger control could hinder the EU's objective related to the security of supply, since only large utilities can afford the investments required in order to maintain and develop an appropriate level of networks and cross-border interconnections.[8]

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[7] In this respect, some voices have called for a stricter application of the merger control in the electric power industry. See for instance Arndt Christiansen, *Regulation and EU Merger Control in the Liberalized Sector*, 2006, available at http://ssrn.com/author=369249.
Indeed, according to some authors, relaxed standards applied to merger operations might lead to a "*replication of effects of past regulation*" and result in anticompetitive effects (PETER C. CARSTENSEN, SUSAN BETH FARMER, COMPETITION POLICY AND MERGER ANALYSIS IN DEREGULATED AND NEWLY COMPETITIVE INDUSTRIES" (Edward Elgar Publishing Limited ed., 2008).

[8] The application of very strict standards could, according to some market participants, hinder the establishment of strong European actors which are required to "*match the power of external suppliers*" (Herbert Ungerer -European Commission-, Some Comments on the Relationship of Competition Policy and European Energy Security, European Review of Energy Markets- volume 2, issue 2 (December 2007)). In this context, and even if it was in the purpose of counteracting theories claiming for a more relaxed enforcement of EU merger control rules, Herbert Ungerer –former Deputy Director General in DG Competition- referred to this debate in several occasions, and particularly when he stated "*[*i*]s this the right time to address the deficiencies in competition? Or are we scrubbing the deck, while the ship is sinking?" (*Speech of Herbert Ungerer -European Commission-, Which Approach to Competition in Electricity and Gas – are we Tackling the Right Issues?, Lublijana (22 May 2008)).

This paper, assuming the necessary interplay between competition law and regulation in the electricity liberalized markets[9], will discuss the extent to which EU merger control should undertake a new (or just traditional but nuanced) approach to mergers in order to facilitate the achievement of the goals of the new energy regulation and, if necessary, whether and to what extent merger control could offset possible gaps of the sector-specific legislation[10], including a potential consideration of non-competition dimensions by DG Competition.[11]

In order to address these questions, section 2 will initiate the study with an analysis of the current state of play of the EU energy legislation. Some relevant features of the electricity markets which characterize this industry as well as a general approach to mergers undertaken by US and EU competition authorities will also be the object of this section.

In sections 3 and 4, the paper will proceed with a comparative analysis of the merger control applied in the electricity sector in the EU and the US (particularly by Federal Energy Regulatory Commission and the Department of Justice at the federal level), leading jurisdictions in the enforcement of competition law. That being said, the comparative study will not be the final goal of the paper but an instrumentality to analyze possible drawbacks of the EU merger control in the light of the new electricity regulation. Moreover, rather than carrying out a comparison between the two systems seeking to determine which of the two is stricter in terms of, for instance, blocked transactions, this paper prioritizes on defining an approach which is more focused on the actual competitive concerns that might arise from a merger within the electric

[9] The importance of the interrelation between competition law and regulation in the electricity market within the framework of a liberalized scenario will be assumed as it has been sufficiently supported by numerous commentators. On the political front, see Neelie Kroes, former European Commissioner for Competition Policy, The interface between Regulation and Competition Law, Hamburg (28 April 2009).
[10] Philip Lowe, *supra* note 4, p. 8 - 9.
[11] Amongst others, considerations related to the security of supply and the completion of the single European electricity market.

industry.[12]

In section 5, the paper will explore whether the current approach of EU merger control is likely not only to take into consideration but also to promote the achievement of the goals of the third energy package, assessing the appropriateness of including non-competition factors within the merger control analysis applied by DG Competition.

Finally, the paper will conclude that electricity might not need a particular test when it comes to the analysis of mergers taking place in this sector. Rather, the test applied -as well as the whole merger control procedure- should be sufficiently flexible in order to take into account the idiosyncrasies of the electricity markets, not limiting the analysis to a mere review of market share and market concentration levels. The inclusion of non-competition related aspects such as the integration of EU markets, the liberalization process itself or security of supply concerns might be also considered by DG Competition.

[12] In fact, some alleged “stricter” systems have proven themselves to be blocking mergers that, in fact, do not represent any harm for competition (so-called false positive) and vice versa.

2. EU Regulatory framework and evolution of the electric power industry

Whereas in the majority of the industries the legislation, if any, adapt itself to the structural configuration of a given sector, in the world of regulated industries (and particularly in the gas and electric businesses) the applicable rules -whether enacted by the legislature, ordered by an administrative agency or influenced by a judicial decision- have at least conditioned (and frequently contributed to shape) the structure of the industry[13]. The process of deregulation and all its intended and unintended consequences (as well as potential regulatory loopholes) that for the last 20 years or more have being taken place in some areas of the US and the European Union[14] have intensified this trend, setting the pace of the electricity sector[15]. However, countervailing tendencies, and particularly a wave of mergers that have occurred in the US and European markets, might have the potential to thwart some of the goals set by the regulation. The merger control enforcer in each jurisdiction should accordingly gauge and differentiate between legitimate transactions that contribute to increase the efficiencies of an organization and eventually bring benefits to the consumers, and the operations that could adversely affect those customers.

In order to grasp the complexities and challenges of enforcing merger control rules in the electricity sector it is necessary to approach the legislative configuration and idiosyncrasies of this sector. To that end, this section begins reviewing the European Union’s legal moves to open up the competitive segments of the electric power

[13] For instance, in the context of the natural gas industry, the Hope Natural Gas case (320 U.S. 603 (1944)) and its decision about the rate base and rate of return of transmission and supply activities, conditioned the disaggregation of the transmission assets of the utilities. The Public Utility Holding Act of 1935 also limited for years the expansion of utilities’ activities to multiple states in the US as well as subjected to approval the right of these companies to engage in non-utility business.

[14] Remarkable processes of liberalization of the electricity sector have also taken place, amongst others, in the UK –prior to the EU liberalization boost-, Chile, Argentina, New Zealand and some areas of Australia.

[15] While the vertical integration of the electric industry was considered a natural trend of the business, driving companies to aggregate generation, transmission, distribution and supply activities, factors such as governmental incentives, unbundling orders, supply obligations or rates of return set by the regulators have promoted competitive markets at the generation and supply levels, where newcomers reshape the structure of the industry.

industry, which eventually have led to the approval of the third energy package. This overview is followed by an approximation to the industry structure and main features that condition this business and its subsequent merger analysis.

a. Overview of the EU electricity legislation: a long way towards deregulation and single-market integration

The European Union -and particularly the European Commission- has traditionally believed in the completion of a single European integrated market as a key driver for increasing overall prosperity in the EU.[16] The Single European Act, adopted in 1986, advanced one more step in the development of this integrated market goal by introducing the notion of the Internal Market, which was defined as “*an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured*”.[17]

On the energy front, and particularly in the fields of electricity and gas, the completion of the Internal Market was considered by the European Commission as an essential step to ensure the establishment of competitive markets that would result in more choices for the consumers in terms of electricity supplier, better quality of the services and lower prices, at the same time as security of supply would be guaranteed. In order to translate those objectives into practical measures, in the 1990s the EU launched a process to open electricity markets to competition by liberalizing them -moving away in some cases from vertically integrated state-owned electricity companies-, with the additional prospect of reaching a single European electricity market.[18]

[16] Treaty Establishing the European Economic Community, 25 March 1957, art. 2.
[17] Single European Act, O.J. L 169/1 (1987), art. 13.
[18] It is noteworthy that the goal of liberalizing the electric power industry –similar to the deregulation process pursued by other jurisdictions out of the EU- was added to the objective of creating a single European market. Some resemblances could be made between the latter objective and the principles underlying the interstate commerce clause at the US level. Nevertheless, when it comes to the electric

The first liberalization directives on electricity were adopted in 1996[19], with the purpose of opening up the electricity markets by gradually introducing competition at the generation and supply levels ("first energy package"). The Directive 96/92/EC, while laying down that the achievement of a competitive electricity market was an important step towards completion of the Internal Market, acknowledged that such Internal Market in electricity should be implemented gradually, "*in order to enable the industry to adjust in a flexible and ordered manner to its new environment and to take account of the different ways in which electricity systems are organized at present"*.[20] Accordingly, this piece of legislation set general conditions relating to, for instance, the organization and functioning of the electricity sector, access to the transmission and distribution network and the operation of systems.

Regrettably, the own shortcomings of an early legal framework for the electric industry deregulation as well as the reluctance of a number of stakeholders and Member States not completely adherent to the liberalization trend (in some cases failing to properly implement the directives in their own national legislation) thwarted the achievement of the integration and liberalization goals. However, the EU determination of pursuing the development of the liberalization process brought about the enactment of a second set of directives in 2003[21] ("second energy package"), in which there were included, amongst others, unbundling provisions whereby electricity transmission networks had to be run independently from the production and supply side.[22] Other

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power industry, the EU ambitions appear to be broader than the federal electric outreach insomuch as the jurisdiction of the European Commission is not only confined to the EU equivalent of interstate transmission and wholesale activities.

[19] See particularly, Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996, concerning common rules for the internal market in electricity.

[20] *Id.* at section 5.

[21] See specially Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC.

[22] As it has been noted in previous sections -and will be further developed within this paper- the disaggregation of the transmission and distribution activities in the electricity markets from the generation and supply activities has progressively become one of the landmarks of the electricity liberalization

energy related issues were also dealt with, particularly the security of supply and reduction of the environmental impact of energy use. According to these second set of directives, markets for all non-household electricity customers would be liberalized no later than July 2004, whereas residential customers should wait until July 2007 in order to be able to choose their electricity supplier in a competitive market.

b. Emergence of the EU "Third Energy Package"

The foregoing legislation was conceived to drive the EU electric power industry to a truly liberalized scenario. However, the mechanisms provided by the second energy package to accomplish that enterprise fell short, and competition in the European electricity markets did not flourish as expected. Indeed, as a result of the findings derived from the sector inquiry conducted by the European Commission in 2005 and 2006 in the EU electricity and gas markets[23], doubts were casted about the second energy package's capacity to contribute to the completion of the internal energy

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process.

As a matter of comparison, on the US front the attempts of the Federal authorities to reach this separation have been conditioned by their lack of authority over intrastate matters and the reluctance of Congress to foster this process. Thus, functional unbundling was required by Order 888 issued by FERC in 1996 –a landmark of the US deregulation- as a means of assuring non-discriminatory open access to transmission. Conversely, the operational unbundling alternative (consisting of the fact that "*utilities would continue to own transmission lines, but an independent system operator would have operational control"*) received the "moral" support of different federal authorities (particularly the Federal Energy Regulatory Commission, but also de Department of Justice and the Federal Trade Commission) but was not mandatory. Those systems operators (that have been voluntarily created in some regions of the US under the form of Independent System Operator (ISOs) and Regional Transmission Operators (RTOs)) aim at guaranteeing open and equal access to all electricity market players as well as strengthening reliability of the transmission stage in a certain area –taking care of proper investment in grid improvements, congestion management, etc.

Roughly speaking, the absence of a specific Congress boost to liberalize the markets as well as the jurisdictional peculiarities inherent to a Federal system have prevented the US from following an homogenous pattern on the restructuring of the electric industry. Thus, the final configuration of the wholesale and retail markets have not been uniformly set in the US. Instead, the different states have been responsible for setting the pace and outreach of the deregulation. For further information on electricity deregulation processes, see JAMES M. GRIFFIN AND STEVEN L. PULLER, ELECTRICITY DEREGULATION: CHOICES AND CHALLENGES (Volume IV in the Bush School series in the Economics of Public Policy, University of Chicago Press, 2005).

[23] The European Commission launched in 2005 a sector inquiry in order to identify, and subsequently address, those factors that prevented the gas and electricity markets from achieving high levels of competition. Preliminary results of the inquiry were issued in 2006 and the definite findings were published in 2007.

market.[24] Indeed, in addition to the problems that arose from the incomplete implementation of the 2003 directives[25], the European Commission detected that the legal framework, and particularly the directive 2003/54 related to electricity, did not address some of the structural problems of the industry that had to be handled as a precondition for the completion of the Internal Market.

Issues such as the high level of market concentration of the electricity and gas markets, vertical integration (of supply, transmission and generation activities), absence of adequate cross border interconnection (which inevitably leaded to an insufficient integration between Member States' markets), or lack of transparent information on the market functioning, raised concerns in the European Commission.[26] More concretely, the European Commission identified a series of deficiencies of the legal framework that, amongst other factors, led to that unintended situation. In general terms, they referred to the lack of performing regulation on cross border interconnection, scarce powers granted to national energy regulators and insufficient unbundling requirements in order to guarantee non discriminatory access to the networks.[27]

Against this backdrop, in 2007 the European Commission launched a third legislative energy package proposal with the purpose of addressing factors that, until that time, had hampered the opening up of the electricity and gas markets in Europe. The legislation consisted of two directives and three regulations.[28] The objectives of the

[24] Since the Hampton Court meeting of Heads of State and government in 2005, and the subsequent green paper on an European strategy for sustainable, competitive and secure energy approved in March 2006 (COM (2006)105 final), the energy internal market has increasingly become political priority for the European Institutions.

[25] Infringement procedures were opened at that time against more than half a dozen Member States for failing to transpose –or insufficiently implement- the directives 2003/54 in electricity and 2003/55 in gas. For a quick review of the infringement procedures opened by the European Commission against Member States for failure to transpose directive 2003/54, see http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/06/152&language=en.

[26] Communication from the Commission, Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) (January, 2007).

[27] Commission Staff Working Document, Accompanying the legislative package on the internal market for electricity and gas: Impact assessment (2007).

[28] Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009

third energy package focused again on the achievement of the internal energy market which would pave the way for significantly increasing the consumer choice, keeping prices “as low as possible”, maintaining an environmentally sustainable framework and improving the standards of security of supply.[29]

On the electricity front, the above mentioned pitfalls of the market functioning were addressed through specific measures. Thus, the European Commission initial proposal sought to move forward on the degree of separation of generating and supply activities from network operation by promoting ownership unbundling, which should lead to “*eliminate conflict of interests, promote network investment and prevent any discriminatory behavior*”.[30] While both transmission and distribution activities are subject to unbundling requirements, the European Commission particularly focused on the separation at the transmission level given its key role in broadening cross border flows, what could in turn drive the integration of EU electricity market.[31]

As an alternative to the ownership unbundling option, the European Commission authorized the vertically integrated companies to preserve the ownership over the network provided that its management was entirely run, “*in terms of operations and investments”*[32], by an independent undertaking, the so-called Independent System

establishing an Agency for the Cooperation of Energy Regulators.
Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003.
Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005.
Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.
Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC.

[29] Directive 2009/72, *supra* note 28.

[30] Communication from the Commission to the European Parliament pursuant to the second subparagraph of Article 251(2) of the EC Treaty concerning the common position of the Council on the adoption of a Directive of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC. Section 2 (p. 3).

[31] Neelie Kroes, *Improving competition in European Energy markets through effective unbundling*, 31 Fordham Int'l L.J. 1387, 1419 (May 2008).

[32] *Id.* at 1418.

Operator (ISO).[33] While the European Commission expressed its strong preference for an option that would completely exclude the incumbents from the ownership over transmission wires –being considered as essential facilities for the functioning of the electric industry-, it reluctantly accepted that an effective[34] implementation of the ISO alternative might lead to the same results.[35]

Additionally, the European Commission's energy proposal sought to eradicate some other pitfalls of the electricity market by increasing the powers granted to the National Energy Regulators. This measure should particularly lead to an enhanced overview of the electricity markets. Additionally, the proposal imposed compulsory cooperation between Member States in issues related to cross border electricity networks, including coordination of investment schemes in transmission lines.[36]

Against this background, the final version approved in 2009 of the pieces of legislation composing the third energy package, and particularly the directive 2009/72 concerning common rules for the Internal Market in electricity, diluted some of the key aspects initially included in the proposal. Particularly, a third alternative for the separation of generation and supply activities from the network operation was finally included at the request of some Member States.[37] This new approach (referred to as the

[33] Directive 2009/72, *supra* note 28, art. 13.

[34] Effective implementation implies, amongst other factors and according to the Directive 2009/72, a complete ten-year network development plan, to be approved by the regulatory authority. Directive 2009/72, *supra* note 28, art.13.2.c.

[35] See speech of Neelie Kroes, former European Commissioner for Competition Policy, Structural Reforms to the Energy Market, Brussels (27 February 2008).

[36] Another aspect that was tackled by the European Commission's proposal related to the mergers operations in which companies from non EU countries intend to acquire, directly or indirectly, electricity network infrastructures within the boundaries of the European Union. The proposed regulation sought to require non EU entities to comply with the same unbundling requirements as EU companies, giving the European Commission authority to intervene should the unbundling standards were not fulfilled.

[37] France and Germany led the group of countries dissenting from the ownership unbundling proposal. Whether this position was truly based on an elaborated reasoning of the virtues of mechanisms implying a certain degree of vertical integration or, conversely, on a more mundane motivation implicitly related to the support of national companies is beyond the scope of this paper though.

Numerous dissertations on the appropriateness of an ownership unbundled option have been written. See for instance Michael Pollitt, *The arguments for and against ownership unbundling of energy transmission networks*, ENERGY POLICY 36, 704–713 (2008).

"Independent Transmission Operator" –ITO-[38]) enables "*transmission system operators to remain part of integrated undertakings but provides for detailed rules on autonomy, independence and investment, plus a specific revision clause which can lead to legislative proposals of the Commission".*[39] While the European Commission has abided by the compromise reached between the European Parliament and the Council on this issue, its concerns about the risk of an ineffective implementation of this ITO alternative -that might replicate the pitfalls of past regulation- have been reflected in some of the pronouncement of its representatives.

Being still 12 months away from the actual deadline for the implementation of the bulk of the third energy package into the different national legislations (Member States are required to bring into force the legislative measures necessary to comply with the electricity directive by 3 March 2011), it is still too soon to determine whether these regulatory enhancements are successful in their endeavor of bringing up the completion of the liberalization and integration process.

However, interestingly enough, apart from the regulatory measures put forwarded by means of legislative proposals, the European Commission has acknowledged, at least in theory, the need of addressing some of the ills of the electricity markets –particularly those related to structural market conditions- by means of a "stricter" enforcement of competition law rules (both on the EU merger control and antitrust fronts). This will not necessarily mean that mergers in the electricity industry are going to be persistently banned for the sake of attaining the regulatory goals[40], but that a closer scrutiny –

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[38] Directive 2009/72, *supra* note 28, chapter 5.

[39] Communication from the Commission to the European Parliament pursuant to the second subparagraph of Article 251(2) of the EC Treaty concerning the common position of the Council on the adoption of a Directive of the European Parliament and of the Council concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.

[40] The European Commission itself acknowledged in its 2004 Strategy paper for the internal electricity market the benefits resulting from merger operations in the electricity sector (particularly the economies of scale and scope), stating that "*[*e*]lectricity companies should not, in principle, be prevented from taking such actions to improve their performance provided that customers are protected from*

focused on the actual effects of a merger in the effective competition- should be undertaken.

c. General approach to the merger control in different jurisdictions. Specific features of the electricity markets

While being a prerequisite for the liberalization of the electricity markets, regulatory initiatives such as third party access requirements cannot reach that goal by themselves. Effective economic regulation is a key driver for bringing real competition to the electricity industry, and amongst other tools, merger regulation rules play a major role. Within the framework of successive waves of merger operations taking place in the energy sector during the last 20 years, merger control enforcement has been increasingly but inconsistently used to limit market power in the electricity field, especially as a result of the burdensome (and not always effective) alternative consisting of using some measures associated to sector-specific regulation for that same purpose (such as price caps or capacity obligations).[41]

Now, side by side with the new regulatory framework approved in the electricity sector, true time for merger control could have come, becoming the "missing link" required in order to avoid an "undesirable" fourth energy package. However, it is necessary to verify whether the merger control is "well equipped" in order to play that role.

When it comes to the enforcement of merger control regulation, a comparison between the US and EU systems (leading jurisdictions in the application of competition law) could result an obscure mission, especially if its outcome is supposed to be

monopolistic or oligopolistic practices and that new entrants and smaller companies are not unduly disadvantaged", DG energy and transport "Strategy paper: medium term vision for the internal electricity market" p.16 (1 March 2004).

[41] For instance, see Gilbert, R. and D. Newbery paper "Electricity merger policy in the shadow of regulation", and particularly the reference to the US experience suggesting that regulatory measures to limit market power implies "*continuous monitoring of deregulated electricity markets. Such monitoring incurs a risk of intrusive intervention*". In their view, previous experiences such as the California energy crisis would serve as a support to opt for structural remedies over behavioral remedies.

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measured in terms of blocked transactions as a result of the review. In fact, as it has been advanced in previous sections, this paper supports a model of merger control consistent with the objectives of the merger analysis at both sides of the Atlantic (at least when it comes to the DOJ and the European Commission), and therefore an approach that analyzes mergers through the lens of the real competition concerns that might arise from those transactions.

Thus, the test applied to review concentrations in the electricity industry will not require a substantially different procedure from the one undertaken when reviewing concentrations in other fields, but just a framework flexible enough to accommodate the specific features of the electricity markets. Statistics in terms of transactions blocked by one or another authority would be otherwise misleading.

Indeed, while a superficial analysis might lead us to conclude that the EU approach could have driven a more interventionist system (based on specific cases cleared in the US and blocked on the European Commission front[42]), the application of a substantive test of dominance in the EU until 2004 -in contraposition to the substantial lessening of competition test applied in US[43]- implied some major enforcement gaps at the European Union level. Then again, as it will be exposed in following sections, the Merger Policy Statement applied by the Federal Energy Regulatory Commission (particularly its Appendix A) has also been subject to criticism when it comes to its effectiveness in screening potential anticompetitive consequences derived from a merger operation taking place in the context of the electric industry.

In the electricity markets, an in-depth scrutiny of the mergers turns out particularly important, as all "megawatts" do not count equally in terms of potential

[42] See for instance the operation M 2220, GE (General Electric) /Honeywell (2001). In this respect, see François Lévêque, *Merger Control: More Stringent in Europe than in the United-States?*, CERNA - Working Paper (November 2007).
[43] A concrete explanation of the different substantive test applied by the European Commission as well as by different authorities at the US federal level are further developed in sections 3 and 4 of this paper.

wielding of market power. An efficient merger control should hence take these factors into consideration. As it will be noted in following sections, strengths and weaknesses can be identified in the merger review undertaken by the different US and EU authorities. The flaws are generally related to the use of analysis which are too dependent on market shares findings. The excessively narrow application of non-competitive factors by some EU Member States will be also discussed.

For the moment, there are some basic characteristics of the electricity markets that render this industry atypical and which are relevant to grasp the challenges of the merger control. They could be depicted as follows. First, electricity is non-storable and must be produced simultaneously with consumption. Indeed, the electric industry requires a constant balance between demand and supply over a certain area. Second, being a network industry, the electricity sector is disaggregated into 4 stages, i.e. generation, transmission, distribution and supply. It is broadly established that the generation and supply activities are the fields where a competitive environment is likely to thrive. Conversely, transmission and distribution activities still remain natural monopolies, with their main players owning infrastructures to which the rest of the market participants need to have access in order to develop their activities. Partly induced by the economies of scale and the high-investments that are required at least in some parts of the chain, electricity markets tend to remain highly concentrated and vertically integrated.

Third, the demand of electricity is highly inelastic, particularly in those jurisdictions where the final consumers enjoy price caps. As a result, the prices of electricity at the wholesale market can barely be disciplined by a reaction of the demand (i.e. decrease in consumption) and hence, in the absence of some additional factors (e.g. abundant generation capacity), the odds for exercising market power increase.

Additionally, there exists a clear difference between types of generators; thus, the so-called baseload generation units[44], given some of their features –amongst others, low marginal costs and relative technical inability to switch on/ switch off their production of energy-, do not set the electricity price in a spot market[45] (a commodities market in which electricity is bought and sold in a daily and intra-daily basis). Accordingly, these power generators are less likely to have the ability, on their own, to manipulate prices. On the contrary, peak plants[46] are power plants that generally run only when there is a high demand for electricity -known as peak demand-. They have the ability to ramp up or ramp down their production of electricity and usually set the price of the electricity (depending on the fuel, technology used, etc.). Therefore, when analyzing a merger, competition authorities have to consider not only the number of megawatts disposed but the merging companies (market shares in a given market) but also the particular features of a specific generator (for instance, whether one of the merging companies dispose of marginal units that could set the clearing prices).

Another particularly relevant factor to be considered when analyzing mergers in the electricity sector refers to the growing use of different types of natural gas-fired generation technologies, leading gas to become a significant input in the production of electricity. Thus, while gas-fired plants usually represent a minority of the electricity

[44] Base load plants include amongst others coal-fired plants, some hydroelectric generators and nuclear power plants.

[45] Spot markets have been recognized as a milestone in the introduction of competition to the electricity generation markets. Roughly speaking, the price, which is set based on demand and supply factors, is the same for all the producers, regardless the different marginal costs. As explained by Professor Peter Cramton, "*Buyers submit demand bids and sellers submit supply offers. The auctioneer then forms the aggregate supply and demand curves, and finds the clearing price at which supply and demand balance; that is, where the supply and demand curves cross. All demand bids above the clearing price and all supply offers below the clearing price are accepted. The winning buyers pay the clearing price and the winning sellers are paid the clearing price for their accepted quantities.*"(Foreword to report elaborated by Professor Ross Baldick on "Single Clearing Price in Electricity Markets", February 2009.)
The volatility of prices that might result from this mechanism can be mitigated, amongst others, through limited long-term contracts or financial systems to hedge risks, such as the over-the-counter markets. In some cases, electricity imports from other adjacent markets can also help to discipline market prices and hence limit potential market power.

[46] Gas-fired plants are one of the most significant examples of peaking power plants.

generation (mainly dominated by nuclear or coal sources[47]), natural gas has usually been positioned as the common marginal fuel, that it’s to say, the energy source used by the power plants that submit the last accepted offer in a spot market and, therefore, the units that set the electricity price at a given time.[48] Accordingly, mergers between gas and electricity companies can be observed as vertical integration with a potential to bring competition concerns; indeed, it does not result difficult to figure out the incentive for a gas company acquiring an electricity undertaking to raise the prices of gas, resulting in higher proceeds stemming from the electricity production of its new acquired company. Another result of this kind of vertical merger operations can consist of discrimination on the gas supplied to competitors in the electricity market.

Finally, due to some extent to the already referred lack of storability, the system frequently needs capacity reserve for generation as well as significant transmission capacity that might guarantee the security of supply at all the times. Due to the limitation of transmission infrastructures, the congestion management as well as the geographical distribution of the plants also remain important elements to be taken into consideration in this industry.

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[47] One exception to this principle occurs in Texas, where 50% of the electricity is generated from gas-fired power plants. L.LYNNE KIESLING and ANDREW N. KLEIT, ELECTRICITY RESTRUCTURING: THE TEXAS STORY, p. 37 (American Enterprise Institute for Public Policy Research, 2009).

[48] For a further explanation on the weight of fuel costs in the electricity prices, see Kenneth Rose, *The Impact of Fuel Costs on Electric Power Prices*, 2007, available at: http://www.appanet.org/files/PDFs/ImpactofFuelCostsonElectricPowerPrices.pdf
An overview of the current US electric power markets could also be found at the following FERC website http://www.ferc.gov/market-oversight/mkt-electric/overview.asp

3. US Merger Control in the electricity markets

a. Multiplicity of Authorities: a special focus on DOJ and FERCs jurisdiction to review mergers in the electricity industry

While there are thresholds in the EU that, in the majority of the cases, enable to determine whether a merger shall be analyzed under the EU merger control rules or by the national competition authorities[49], the US approach to merger review in the electricity sector implies that numerous authorities are entitled to intervene in the analysis of a takeover. The Department of Justice (DOJ) as well as –at least theoretically- the Federal Trade Commission (FTC), the Federal Energy Regulatory Commission (FERC), the States Public Utilities Commission, States Attorneys General and Private Plaintiffs might be involved in the analysis of a merger operation within the electricity sector. Such a multiplicity of merger reviews, and particularly the shared jurisdiction between FERC and FTC/DOJ at a federal level, has raised some reservations about the efficiency of the system, particularly as a result of the high costs that numerous merger analyses might imply both for the concerned companies and the taxpayers.

Notwithstanding that underlying question, and even if states do have the right to analyze certain aspects of merger operations in the electricity sector (it has occurred in certain occasions that state agencies have blocked merger transactions already cleared

[49] When the European Commission, based on different thresholds reviewed later in this paper, is not competent to analyze a particular merger under the EU merger regulation 139/2004, the transaction might fall under the jurisdiction of various national competition authorities as well as the pertinent national regulatory authorities, according to the merger approval procedure established in each Member State. In those cases, while the above mentioned EU merger regulation provides in its recitals, and particularly in its article 22, with the possibility to request that "[o]*ne or more member states may request the Commission to examine any concentration as defined in Article 3 that does not have a Community dimension within the meaning of Article 1 but affects trade between member states and threatens to significantly affect competition within the territory of the Member State or States making the request*", the non-mandatory nature of the request for referral as well as the right of any Member State to oppose to it render the analysis of a merger by a multiplicity of authorities a real scenario.

by the rest of the competent authorities)[50], the following analysis will exclusively focus on the merger review powers attributed to FTC/DOJ and FERC.[51]

As for the FTC and the Antitrust Division of the DOJ, both Institutions share jurisdiction in the review of merger operations. When it comes to the energy field, however, the clearance process whereby these two agencies determine which of them will tackle a particular operation has traditionally resulted on the DOJ being granted the review of mergers involving electricity-related companies.

The pre-merger review process[52] applied by the DOJ, as the one undertaken by FTC in the gas-related takeovers, aims at watching over the principles established in the section 7 of the Clayton Act that prohibits mergers and acquisitions “*where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly*”.[53] Likewise, sections 1 and 2 of the Sherman Act[54] - forbidding contracts, combinations or conspiracies in restraint of trade or commerce as well as monopolization and attempts to do so-, might apply to hypothetical anticompetitive consequences stemming from merger operations.

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[50] One of the alleged reasons asserted in 2006 by Exelon Corp. and Public Services Enterprise Group (PSEG) to abandon the proposed merger between these two companies after two years of merger review proceedings, consisted of the conditions imposed by the New Jersey regulator to the operation that, at that moment, had received the approval – in some instances subject to conditions- of other federal and state agencies. The transaction, should it had finally fructified, would have resulted in one of the largest energy companies in the US. For a further analysis of this operation and the analysis undertaken by the federal authorities, see Wolak, Frank and Shawn McRae, *Market Analysis in Restructured Electricity Supply Industries: The Proposed PSEG and Exelon Merger*, THE ANTITRUST REVOLUTION (2006).

[51] For a further approach to the merger control applied by the Public Utility Commissions, see Carl R. Peterson and Karl A. McDermott, *Mergers and Acquisitions in the U.S. Electric Industry: State Regulatory Policies for Reviewing Today’s Deals*, 20 ELECTRICITY JOURNAL (Jan./Feb. 2007).

[52] See 15 U.S.C. § 18a (1997 and Supp.2002).The Hart-Scott-Rodino Act requires the concerned companies to provide the FTC and the DOJ with information about mergers and acquisitions prior to the completion of the operation. A similar system is established at the EU level through article 4 of Regulation 139/2004, requiring notification to the European Commission of mergers with a Community dimension –as defined in that Regulation- “*prior to their implementation and following the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest*.”

[53] 15 U.S.C. &18.

[54] 15 U.S.C. &1.

In this respect, the review of mergers under the foregoing principles does not only refer to the most common horizontal concentrations between two companies competing in the same market, but also affect, particularly as a result of the Supreme Court decision in *Brown Shoe Co. v. United States*[55], to vertical and conglomerate mergers. The application of section 7 of the Clayton Act to non-horizontal operations[56] turns out to be particularly relevant in the electricity sector given the characteristics of this industry, in which vertical issues are likely to arise (such as potential discrimination resulting from power generating companies owning transmission infrastructures[57] or the increasing dependence of electricity generator units on gas and gas-related infrastructures).

Particularly, the already mentioned role of gas as a key fuel in the production of electricity has been increasingly stressed in the last decades, turning into a particular area of concern in the context of merger control. Additionally, the gas companies are considered the best suited players to become -in the mid-term- potential competitors in the electricity markets[58]; consequently, in practice, the acquisition of a gas company by an electricity undertaking might entail the loss of direct competition in the electricity

[55] 370 U.S. 294 (1962). For further discussion on the incorporation of vertical mergers to the scope of review under section 7 of the Clayton Act, see AMERICAN BAR ASSOCIATION, MERGERS AND ACQUISITIONS: UNDERSTANDING THE ANTITRUST ISSUES 439 (3d ed. 2008).

[56] As defined by the non-horizontal merger guidelines originally issued as part of "U.S. Department of Justice Merger Guidelines", on 14 June 1984, non horizontal mergers involve "*firms that do not operate in the same market*". EU Guidelines on the assessment of non-horizontal mergers define vertical mergers as operations involving "*companies operating at different levels of the supply chain. For example, when a manufacturer of a certain product (the 'upstream firm') merges with one of its distributors (the 'downstream firm')*". In turn, conglomerate mergers are defined as "*mergers between firms that are in a relationship which is neither horizontal (as competitors in the same relevant market) nor vertical (as suppliers or customers)*".

[57] As already advanced in previous notes, the unbundling of the transmission networks from potentially competitive activities such as the electricity generation has become a wide spread tendency across the different electricity systems in the world. Different levels of separation have been imposed though, ranging from the more "drastic" ownership unbundling –implying different owners for different activities- to softer alternative such as the functional and accounting unbundling. For some principal basics on unbundling trends, see OECD/INTERNATIONAL ENERGY AGENCY, COMPETITION IN ELECTRICITY MARKETS (OECD ed., 2001).

[58] See Richard Gilbert and David Newbery, *Electricity Merger Policy in the Shadow of Regulation,* University of California Energy Institute Policy & Economics (2006).

relevant market. Accordingly, even if in general terms non-horizontal mergers are broadly considered as less propitious to create competitive concerns[59], the close review of the effects resulting from vertical transactions remains essential in the electricity field. In this respect, apart from the horizontal merger guidelines jointly adopted by the DOJ and FTC in 1992 and amended in 1997, the DOJ disposes of the non horizontal merger guidelines. It is however surprising that since their approval in 1984 few, if any, vertical concentrations have been challenged by the FTC/DOJ.

On the regulatory front, Section 203 of Federal Power Act confers to FERC authority in order to review merger operations in the electricity sector. It accordingly lays down that no public utility shall sell, lease or dispose of any facility subject to the jurisdiction of FERC without a prior authorization granted from that Commission.[60] In this respect, according to the Federal Power Act, all the facilities used for the interstate wholesale transmission or sale of electric energy fall under the jurisdiction of FERC (being therefore excluded of the jurisdiction of this Commission all activities related to the retail electricity markets).

Particularly, Section 203(a)(4) of the Federal Power Act establishes that

"*the Commission shall approve the proposed disposition, consolidation, acquisition, or change in control, if it finds that the proposed transaction will be consistent with the public interest, and will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit*

[59] Particularly the Chicago School has traditionally maintained that vertical integration reached by means of corporate operations leads to substantial efficiencies and, therefore, should not be hampered.
In the EU, the European Commission, while recognizing the potential harmful effect of vertical mergers, states in its Guidelines on the assessment of non-horizontal mergers that "*non-horizontal mergers are generally less likely to significantly impede effective competition than horizontal mergers*", principally as a result of the potential efficiencies stemmed from the operation as well as the absence of "*loss of direct competition between the merging firms in the same relevant market*". As it has been pointed out before in this paper, such an approach, while being acceptable in theory, does not always result appropriate in the electricity industry given, amongst others, the nature of the gas companies as potential competitors in the electricity markets.
[60] 16 U.S.C. & 824b(a) (1994).

of an associate company unless the Commission determines that the cross-subsidization, pledge or encumbrance will be consistent with the public interest".[61]

In order to determine whether the public interest is put in jeopardy by means of a merger operation, FERC issued a Merger Policy Statement in 1996. Its implementation is analyzed in the following sub-section together with the approach undertaken by DOJ regarding concentrations in the electricity sector.

b. Approaches to merger operations in the electricity sector

The DOJ approach to merger operations in the electricity sector does not substantially differ from the treatment given to concentrations in any other industry. The analysis undertaken is basically set in the FTC/DOJ Horizontal Merger Guidelines[62] and, as succinctly defined in their overview, the procedure revolves around five principal steps that, as a final goal, are supposed to determine whether "*the merger is likely to create or enhance market power or to facilitate its exercise*".[63]

In brief, after a first stage in which the DOJ gauges the effects in terms of market concentration that might stem from the merger (which requires DOJ a preliminary work defining the product and geographic markets), the agency engages in a second step aiming at assessing, based on market concentration and other particular market features, the potential adverse competitive effects that the merger might raise. In a third stage, the DOJ determines whether the potential anticompetitive effects encountered in previous phases might be counteracted by entry opportunities to the concerned market. Finally, in a fourth and fifth steps the agency respectively analyses the possibilities to achieve the gain efficiencies alleged by the companies by other means and whether "*but for the merger, either party to the transaction would be likely to fail, causing its assets to exit*

[61] AMERICAN BAR ASSOCIATION, ENERGY ANTITRUST HANDBOOK (2002)
[62] U.S. Dept. of Justice and Federal Trade Comm'n, Horizontal Merger Guidelines, 57 Fed. Reg. 41,552 (1992).
[63] *Id.*

the market."[64]

The procedural review of mergers under DOJ according to the above mentioned five-steps process should not mislead the reader though; hence, it would be erroneous to assume that should the first phase results in an absence of relevant market concentration an automatic clearance of the operation would be granted.[65] In fact, the Guidelines warn at several occasions from a mechanical application of the abovementioned process, stating that the Authority in charge of the merger review will apply the standards "*reasonably and flexibly to the particular facts and circumstances of each proposed merger*".[66]

In that sense, the authors of the Guidelines (DOJ and FTC) confirmed the evolution in the assessment of market concentration in merger operations initiated by the US Supreme Court in 1974 in its *General Dynamics* decision.[67] In that case, the Supreme Court acknowledged that the analysis of the market concentration provides a first indicator but, nonetheless, no final decision can be made solely upon these results given the fact that both market share and market concentration findings may "*either understate or overstate the likely future competitive significance of a firm or firms in the market or the impact of a merger*"[68] .

On the electricity front, and particularly in the context of a hypothetical merger between undertakings acting in the generation market, the sole analysis of the market

[64] *Id*.
[65] For determining the degree of market concentration in a given market, the Guidelines refer to the Herfindahl-Hirschman Index (HHI), which basically consists of a sum of the squared market share of each of the market participants. Based on the result of the post-merger HHI, the Guidelines provide certain standards in order to determine whether a merger would likely result in anticompetitive effects. Beyond a post-merger HHI of 1000, the DOJ will measure the HHI increase comparing the situation before and after the concentration. For a further detail of the application of this standard at both sides of the Atlantic- the use of HHI has also been adopted by the EU competition authorities-, see Horizontal Merger Guidelines, §1.5 and EC Horizontal Merger Guidelines paras.16 and 19-21.
[66] Merger Guidelines §0.
[67] United States v General Dynamics Corp, 415 US 486 (1974). The Supreme Court moved away in this decision from a prior "structuralist" approach that relied on the conclusions drawn from the concerned companies' market share and degree of concentration.
[68] Horizontal Merger Guidelines §1.52.

shares and concentration levels could lead to overstate the competitive significance of the operation should the merging entities just disposed of large market shares of infra-marginal generation capacity ("baseload" generation units that, given some of their features –amongst others, low marginal costs and technical inability to ramp up or ramp down their production of energy– do not set the electricity price in a spot market)[69]. In such a hypothetical case, a merger review which would confer an absolute value to the market concentration analysis would likely consider the existence of anticompetitive effects. However, regardless the market share or post-merger market concentration, the resulting company would not have gained -as a result of the merger- any ability to exercise market power by manipulating the electricity prices. Conversely, the outcome of a merger operation in which the concerned companies only disposed of limited market shares in peaking plants (as referred in previous sections, these plants usually set the price in a given spot market)[70] would be easily predictable should the merger analysis finalized at the first step.

Additionally, the existence of potential vertical issues -implying competitive concerns in the electricity sector- calls for further analysis beyond the market concentration scrutiny. For these reasons, regardless the result obtained in the first step in terms of level of market concentration, the fact that the DOJ keeps on analyzing the merger potential effects on competition represents a guarantee of a more trustworthy merger control approach.[71]

According to the Merger Horizontal Guidelines, the DOJ continues its analysis by reviewing the possible anticompetitive effects of the proposed merger, opportunities for

[69] For an analysis of the merger review applied within the framework of the Exelon/ PSEG proposed merger, see also Dennis W. Carlton, *Mergers in Regulated Industries: Electricity*, (December 2007).
[70] See sub-section 2.c of this paper.
[71] We will depict later in this section some cases where the absence of that continuity in the analysis prevents the authority itself from appraising the actual consequences of a merger over the effective competition.

other players to enter the relevant markets and possible efficiencies stemming from the operation. Within this framework, it is noteworthy that the abovementioned goal of the merger review (namely, determining the odds of the merger to substantially lessen competition) remains the leitmotiv of the subsequent stages of the analysis.

The Horizontal Merger Guidelines, but also the relatively recent Comments to these guiding documents[72] as well as the general trend of the decisions of the courts in merger cases[73], point at two not mutually exclusive scenarios that, arising from a given merger, might lead to the lessening of competition. First, the increased of coordinated interaction between the market participants, which includes tacit or express "*actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others*."[74] Second, unilateral exercise of market power, primarily consisting of the possibility that the merger may lead to price rises or output suppressions carried out by the resulting company due to the incentives arising as a consequence of the merger. For instance, a merger between close competitors –that before the transaction competed in prices- will result in a less constraining scenario that might spur rises in the prices set by the entity resulting from the corporate merger. As the FTC/DOJ point out in their Commentary to the Horizontal Merger Guidelines, a merger resulting in a monopoly is the most obvious case where unilateral effects are likely to result. However, other variables such as the unilateral conducts that might arise from mergers not even leading to a dominant position of the resulting merged firm (as it frequently happens in oligopolistic markets such as the electric industry) are also

[72] In 2006, the DOJ and the FTC jointly published the "Commentary on the Horizontal Merger Guidelines" in order to "*provide greater transparency and foster deeper understanding regarding antitrust law enforcement"*.
[73] See for instance FTC v H.J. Heinz Co., 246 F.3d 708, 724-25 (D.C. Circ. 2004) when it comes to coordinated interaction; and FTC v. Staples, Inc., 970 F. Supp. 1066 (D.D.C. 1997) as regards unilateral behaviors.
[74] Horizontal Merger Guidelines §2.1. For a further analysis of the DOJ and FTC analysis of coordinated effects, see AMERICAN BAR ASSOCIATION, MERGERS AND ACQUISITIONS: UNDERSTANDING THE ANTITRUST ISSUES 148 (3d ed. 2008).

subject to the review of the DOJ pursuant to the Horizontal Merger Guidelines[75].

In the context of mergers in the electricity markets, and particularly in the concentration operation between Exelon Corporation ("Exelon") and Public Service Enterprise Group Incorporated ("PSEG")[76], the DOJ pointed at potential anticompetitive non-coordinated effects, alleging that the merger would result in a substantially lessening of competition by facilitating “*Exelon's incentive and ability to reduce output and raise market prices*”. Indeed, given the characteristics of the generation units owned at the time by the merging companies (a mix of baseload and peaking plants) the chances for profitably withholding certain electric output (particularly marginal units that set the clearing prices in the spot market in most of the hours) would clearly increase. The physical or economical withholding would most likely imply that a more expensive generation plant would set the clearing price, increasing the benefits of most of the units of the resulting merged firm.

In that same case, the DOJ held the improbable chances of new entries in the fields of transmission or generation, deeming that *“entry through the construction of new generation or transmission capacity would not be timely, likely, and sufficient to deter or counteract an anticompetitive price increase. Given the necessary environmental, safety, and zoning approvals required, it would take many years for such new entry to take place”.*[77] Thus, even if in theory market entry can be considered as a way to mitigate competition concerns derived from a merger, in the electricity

[75] The review of potential post-merger non-coordinated conducts of non dominant companies traditionally applied by the DOJ/FTC contrasted for a long time with the “dominance test” applied by the European Commission until 2004, which, by making dominance a necessary requirement, prevented the competition authority to challenge anticompetitive concentrations not leading to the creation of a market dominant company (frequently occurring in mergers between companies producing close substitutes). This so-called “enforcement gap” of the EU merger regulation, was finally closed by the new Regulation 139/2004 and its new “SIEC” merger test, explained in following sections of this paper. For a closer debate of this issue, see Claus-Dieter Ehlermann, Sven B. Volcker and G. Axel Gutermuth, *Unilateral effects: the enforcement gap under the old EC Merger regulation* (World Competition, 2005).
[76] *Supra* note 50.
[77] U.S. Department of Justice (2006) U.S. v. Exelon Corp., Case No. 1:06CV01138 (D.D.C 2006).

sector –and particularly in the context of not fully liberalized markets-, existing entry barriers frequently thwart this merger defense. The oligopolistic structures usually existing in the electric industry -occasionally in conjunction with some governmental regulation[78]- do not usually favor entries that, according to the Merger Guidelines, must be "*timely, likely and sufficient*".[79]

At this stage of the review, in spite of some anticompetitive effects detected by DOJ in a given proposed merger, the operation will still be eligible for a "green light" should it entails certain efficiencies that otherwise could not be reached (that is to say, merger-specific efficiencies).[80] However, the weight to be given to such efficiencies (i.e. the extent to which anticompetitive effects will be offset by given efficiencies) is still largely debated and not clearly predictable. In order to be taken into consideration by the DOJ, the efficiencies shall not imply reductions in output or service, will be verifiable (vague assertions regarding the benefits of the merger will therefore not qualify), and shall address variable costs of production.[81] Efficiencies leading to quality improvements and, eventually, to price raises might also be considered as acceptable under certain circumstances though.

Finally, for those cases where, given its anticompetitive potential, the operation cannot be cleared in the same terms as it was filed, the DOJ adopted in October 2004 a guide setting the key principles for evaluating commitments proposed by companies.[82] As provided in these guidelines, these measures try "*to prevent the anticompetitive*

[78] See AMERICAN BAR ASSOCIATION, MERGERS AND ACQUISITIONS: UNDERSTANDING THE ANTITRUST ISSUES 204 (3d ed. 2008), in which it is evoked the case United States v. Enova Corp., 63 Fed. Reg. 33,396 (DOJ June 18, 1998) where the regulations on environment and safety issues, amongst others, "*were found as barriers to entry the electricity market*".
[79] Horizontal Merger Guidelines §3.1.
[80] Horizontal Merger Guidelines §4.The EU incorporated the analysis of efficiencies to its merger review by means of the Regulation 139/2004. The lack of actual application of this merger defense is an issue that will be discussed in the following section.
[81] Efficiencies addressing variable costs of production are more likely to be translated into final price reductions. By contrast, fixed cost efficiencies frequently imply outputs cuts. See commentary to Horizontal Merger Guidelines, 57. See also Mike Walker, *Have the economic approaches to merger control in the EC and US converged*, (*International Comparative Legal Guide to Merger Control*, 2005).
[82] Antitrust Division Policy Guide to Merger Remedies, October 2004.

effects likely to result from a merger that the Commission has determined is unlawful”.[83] Interestingly enough, according to the Guide to merger remedies, the final objective of the remedy does not consist of enhancing premerger competition, “*but to restore it*”. This guiding principle, which differs from the philosophy underlying the EU merger control approach (where apart from the restoration of premerger competition, the merger control enforcement seeks to “*develop effective competition in the common market*”[84]), constitutes a key element upon which potential remedies will be defined. The enforceability of the commitments and their configuration upon application of “*sound legal and economic principles”* to the circumstances of the transaction, also remain important aspects to be analyzed.

Accordingly, the DOJ has typically opted for structural rather than behavioral remedies, as expressly recognized in the Guide. This preference for structural actions (mostly in the form of divestitures) is not unusual in the merger control enforcement landscape, being shared –in addition to the FTC at the US level- by the European Commission in the context of the EU merger control enforcement.[85]

While this approach is intended to avoid expensive and time consuming government entanglement in the market (as it frequently occurs with behavioral measures that are developed during a limit timeframe and imply higher supervision), it should not be overlooked that the final objective of these commitments consists of restoring competition. In the electricity sector, the right to access to some essential infrastructures might be a better (or at least additional) measure to achieve that goal.

[83] *Id.*
[84] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, recital 23.
[85] Other aspects that are taken into consideration in the procedure of assessment of potential remedies (in which the European Commission and DOJ approaches are quite similar) refer to the preference for divestitures of existing business entities. As defined in the Guide, business entities refer to units that *“ha*[ve]*] already demonstrated [their] ability to compete in the relevant market*” U.S. Department of Justice, Policy Guide to Merger Remedies, 12 (2004). Likewise, the identity and features of possible buyers and the requirements for the divested assets to render the purchaser an effective, long-term competitor in the market are also factors to be considered by DOJ.

That is to say: the simplicity of the implementation of structural remedies should not prevail over the analysis of the real contribution of a commitment to restoring competition. In practice, however, the DOJ supports only under stringent circumstances "*stand-alone conduct-based remedies*", which, in general, serve to underpin additional structural measures. The DOJ also admits behavioral remedies in some cases where the efficiencies sought by the merger would be sacrificed if divestitures were made. As it will be discussed in following sections when exposing the approach of the EU to commitments proposed by the merging parties, competition authorities should be flexible enough to admit behavioral remedies given their potential to fit into the electric industry needs. Hence, these conditions should not be automatically disregarded.

Finally, it should be noted that, in spite of their significant value in determining whether or not challenging a merger, the Merger guidelines are not binding neither on the FTC/DOJ nor on the federal courts, the latter being ultimately the authorities retaining the power to block a transaction.[86] As it will be further developed in the following sections, the immediacy of the judicial review of a decision taken by the competition authority remains one of the divergences between the US and the EU approach to merger control.

When it comes to the approach to mergers undertaken by FERC, as stated in its Merger Policy Statement, this Commission scrutinizes three angles of a proposed merger, namely "*the effect on competition, the effect on rates, and the effect on regulation*". For the purpose of assessing both the effect on rates and regulation, FERC establishes that companies concerned in a merger operation will be required to propose

[86] In addition to some other substantial divergences already mentioned, the procedure followed before the DOJ differs from the process undertaken in the review of merger operations in the EU, insofar as the US approach in this case is based on a judicial procedure (contrary to the administrative character of the merger review undertaken by the European Commission). Thus, in the merger analysis undertaken by DOJ, the judicial control of the administrative body is exercised simultaneously, while at the European Union level this control comes in a later stage as a result of the judicial review of European Commission's decisions exercised by the European Court of First Instance (now denominated General Court, as a result of the entry into force of the Treaty of Lisbon).

appropriate rate protection for customers as well as commitments that might ensure that no regulatory impact is provoked as a result of the operation.[87]

When it comes to the analysis of the effects of mergers on competition, for the alleged sake of efficiency and in order to avoid unnecessary delays on the analysis of a merger operation, FERC applies an analytical screen, developed in the Appendix A to the Merger Policy Statement. Such a test focuses primarily on the FTC/DOJ Guidelines first step, namely whether the proposed merger will significantly increase concentration and, hence, shall result in a concentrated market.

According to FERC’s view, by applying an analytic screen based on this first step of the FTC/DOJ guidelines in an initial stage of the merger review process, “*the Commission will be able to identify proposed mergers that clearly will not harm competition.*” Therefore, it turns out that, while the election of the FTC/DOJ guidelines as baseline to develop the analysis of a merger could be understood as a minimization of differences between DOJ and FERC approaches, the simplification of the process by pursuing an accelerated first screening based on market concentration effects does adulterate the strengths of the test (particularly with regard to the electricity market due to its specific features).

Certainly, the approach applied by FERC establishes that whether “*applicants satisfy this analytic screen in their filings*” – being the screen mainly carried out and based on applicant’s efforts and submissions- “*they,* [the applicants]*, typically would be able to avoid a hearing on competition*”. The analytic screen, sustained on four main steps –i.e. identification of relevant product, analysis of geographic markets on the supply and demand sides[88], and analysis of concentration levels-, expressly makes clear

[87] Effects over state regulation are not considered by FERC, letting the pertinent state commissions protect their own state interests. Inquiry concerning the Commission’s Policy under the Federal Power Act: Policy Statement, 61 Fed. Reg. 68,595 (1996). (hereinafter the Merger Policy Statement).
[88] Merger Policy Statement, refers to the identification of customers who may be affected by the merger

that if no significantly increase of concentration stems from a merger, "*the Commission will not set this issue for hearing*".

The capacity of manipulating the electricity markets by market participants which do not significantly increase their market share is ignored by applying this logic. But even more surprisingly, where significant increases in market concentration do occur, potential remedies offered by the parties can replace FERC's analysis of competitive effects, market entry alternatives and efficiencies.[89]

In that sense, FERC has clarified -upon request of interested parties about the sufficiency of the analytic screen- that Policy Statement "*help[s] to identify mergers that have the potential to harm competition, but that the Commission's review goes beyond those screens and looks at all relevant factors regarding the effect on competition*." [90] Even if it is encouraging that FERC recognizes the need of going beyond the analytic screen[91], the analysis of actual effects on competition appears, in practice, to still be consigned to oblivion.

Explanations of FERC's approach to mergers frequently point at aspects such as the absence of sufficient FERC's powers to wield its functions, and particularly the lack of subpoena power as well as the use of the analysis provided by the merging parties (not surprisingly these reports provided by the parties frequently "demonstrate" that the transaction does not harm competition). Moreover, FERC makes an assumption that, while reasonable in theory, if misunderstood, can lead this agency to an inappropriate application of the merger control. Indeed, FERC assumes that the legislature did not

as well as potential suppliers that can compete to serve a given market or customer.

[89] For a comparative analysis of the powers granted to FERC and DOJ within the framework of mergers in the electricity industry, see Diana L. Moss, *Antitrust Versus Regulatory Merger Review: The Case of Electricity*, Rev Ind Organ (2008).

[90] See for instance, Supplemental Policy Statement (issued 2/21/2008).

[91] FERC's concerns increasingly focus on the consequences of the mergers that allow -and induce- the resulting merged firms to withhold output in order to increase the market price. It hence takes into account that "*the ability to withhold output depends on the amount of marginal capacity controlled by the merged firm, and the incentive to do so depends on the amount of infra-marginal capacity that could benefit from higher prices*".

intend this Commission to be "*hostile*" to mergers. However, the risks stemming from a control that in practice frequently relies upon market concentration levels –ignoring real effects in competition- might bring undesirable consequences that have nothing to do with the fact of being hostile to mergers.

Finally, when it comes to the measures proposed in order to address controversial aspects of a merger, FERC's approach, contrary to DOJ, lean on behavioral remedies.[92] Thus, in several cases FERC subjected its merger clearance to the commitments made by the merging companies regarding, for instance, the creation or adherence to an Independent System Operator.[93] More recently, FERC decided to foster Regional Transmission Organizations in the pursuit of the same objective of creating wholesale markets.[94] Such conditions imposed by FERC for the clearance of a merger, which are closely related to the deregulation energy-policy objective pursued by this regulatory agency, will be the object of further review in section 5 when considering the appropriateness of including non-competition considerations in the merger control analysis.

[92] See Moss, *supra* note 87, where the author illustrates the different approaches to remedies undertaken by DOJ and FERC, analyzing nine significant mergers where remedial measures were deemed necessary. According to that analysis "[i]*n all cases, FERC remedies were behavioral. In three of the seven cases reviewed by the DOJ or FTC, behavioral remedies were imposed (PacifiCorp/Energy Group PLC (Peabody Coal), DTE Energy/ MCN Energy, and CMS Energy/ Panhandle Eastern) but exclusively in vertical merger cases."*

[93] An operator controlling transmission lines owned by its members; the main consequence of that situation consists of creating competitive wholesale markets, being this a key aspect of the liberalization process.

[94] For a further view of the development of FERC's goals and resources to achieve those objectives, see PETER C. CARSTENSEN, SUSAN BETH FARMER, COMPETITION POLICY AND MERGER ANALYSIS IN DEREGULATED AND NEWLY COMPETITIVE INDUSTRIES (Edward Elgar Publishing Limited, 2008).

4. EU Merger Control in the electricity markets

While the efforts of the European Commission during the last 15 years have focused on the integration and liberalization of the EU electricity markets, the statistical data show us how the business tendency has driven this industry towards a high level of concentration.[95] This effect does not appear to be a unique feature of the European markets though. Indeed, significant concentration in the electric industry remains a constant characteristic at both sides of the Atlantic.[96] Particularly in the EU, the liberalization process launched by the EC in the late 1990s was accompanied by a wave of merger operations that has progressively reduced the number of market participants in the electricity markets, particularly at the generation and retail levels.[97]

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[95] Communication from the Commission: Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) (2007).
Additionally, see PETER CAMERON, "COMPETITION IN ENERGY MARKETS. LAW: LAW AND REGULATION IN THE EUROPEAN UNION 325, (Oxford ed., 2002), which refers to some of the reasons underlying the lack of corporate interest of entering into merger operations prior to the adoption of the First Energy Package, e.g. "*compartmentalization of national markets and the use of closed supply areas"* implying a shield for incumbents against competition.

[96] Competition in Energy Markets, Study by the UNCTAD secretariat, 26 (2007).
As a possible reason for that trend, Gilbert, R. and D. Newbery's paper, "Electricity merger policy in the shadow of regulation" points at the incentives for the gas and electricity companies "*to enter each other's markets for the final product (gas or electricity supply) and acquiring firms in the other fuel market*."
David Newbery, in its paper "*What are the issues in mergers in acquisitions arising from the electricity markets restructuring?"*(Florence School of Regulation, 2007) also points at the mergers between generation and supply companies in the electricity industry as an appropriate way to reduce risks stemming from the variation in electricity wholesale prices, which, where no vertical integration occurs, is more likely to alternatively affect to one or the other activity depending on whether prices are higher or lower. Generally speaking, high wholesale prices will increase generation profits while striking energy suppliers, tied to selling contracts to final customers at fixed prices –though hedging these contracts in "Over the Counter" (OTC) energy markets might mitigate exposure to fluctuations of the prices. Moreover, non-residential customers are progressively adapting their electricity contracting patterns to more sophisticated contracts schemes offered by electricity suppliers (indexing electricity prices to several factors) and, thus, limiting the exposure of the supply activity to variations in the wholesale prices.

[97] See Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) (2007) carried out by the European Commission in 2005 and 2006.
The impact assessment carried out by the European Commission prior to the launching of the third energy package proposal in 2007 shows that in countries like France, Greece, Belgium or Estonia, the market share of the largest generator in the electricity market reached up to a 92,7%. Commission staff working document, accompanying the legislative package on the internal market for electricity and gas, Impact assessment, Annex 2 (2007).
Moreover, the report illustrated an average market share of the largest generator in the countries where legal unbundling had been introduced reaching the 73%. Countries having opted for the ownership separation of the network functions from the generation and supply activities also retained in 2005 soaring degrees of concentration. See Communication from the Commission to the European Council and the European Parliament: an Energy Policy for Europe (January, 2007).

In addition to the existing horizontal concentration, vertical integration of the different phases of the electrical power industry has also been stressed, particularly between generation and supply. The not always effective provisions requiring the unbundling of supply and generation interests from network infrastructures has also exacerbated the degree of vertical integration.[98]

As a result, and probably as an unexpected consequence of the liberalization process, the four or five largest operators currently dominate the electric European landscape[99], whether in their initial national market of reference[100] or in other geographic markets through the companies that they have acquired through subsequent merger transactions.[101]

This trend, along with the findings on significant levels of vertical integration as well as the hoarding of strategic network infrastructures and power generation facilities by some market players, has obviously drawn the attention of the European Commission, becoming one of the major concerns of its Directorate General for Competition. Indeed, conscious of the dangers stemming from both the horizontal concentration (particularly the risk of exercising market power by dominant players that, in most of the cases, will result in higher prices for consumers) and vertical integration[102], the European Commission has called for a specific action under the EU merger control in order to "*ensure that the competitive structure in relevant markets*

[98] DG COMPETITION Report on Energy Sector Inquiry, Part II, 169 (January 10, 2007).

[99] See Competition in Energy Markets, Study by the UNCTAD secretariat, 26 (2007).
Particularly, according to the "Report on progress in creating the internal gas and electricity market" published by the European Commission in 2009, "*on the electricity wholesale market, the three biggest generators still control more than 70% of generation capacity in 15 member states*".

[100] EDF/GDF dominate the electricity and gas markets in France, with market shares in both generation and supply proximate to 90%.

[101] E.g. E.ON, RWE, ENEL.

[102] Vertical integration provokes, amongst others, the reduction of the incentives to trade on wholesale markets, decreasing their liquidity when the vertical integration refers to generation and supply activities. Moreover, it discourages the concession of third party access and reduces the incentives to invest in the development of the network, when the integration relates to supply and network activities. DG Competition Report on Energy Sector Inquiry, Part II, 169 (10 January 2007).

does not further deteriorate".[103]

Apart from the regulatory measures put forwarded by means of sector-specific legislative proposals, the European Commission acknowledged the need of addressing some of the ills of the electricity markets –particularly those related to structural conditions- through a stricter implementation of competition law (both on the EU merger control and antitrust fronts).[104] Thus, both national and EU competition authorities are called to play a significant role in order to deal with some of the above mentioned structural problems of the electricity markets. Furthermore, an appropriate interaction of initiatives launched on the competition field with the measures undertaken at a regulatory level has been persistently demanded by both public authorities and commentators.[105]

Against this backdrop, the question of whether a different approach to the EU merger control should be undertaken in order to cope with the goals set in the electricity field has been raised. A change of direction in the approach of competition authorities to the merger control might be particularly necessary if the different periodic reports[106] to be issued by the European Commission on the progress of the internal electricity market

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[103] Communication from the Commission Inquiry pursuant to Article 17 of Regulation (EC). No 1/2003 into the European gas and electricity sectors (Final Report) Point 42 (January, 10, 2007).

[104] Commission staff working document accompanying the legislative package on the internal market for electricity and gas, 6, 9 (2007).

Communication from the Commission Inquiry pursuant to Article 17 of Regulation (EC). No 1/2003 into the European gas and electricity sectors (Final Report) Point 3 (10 January 2007).

[105] It is to be highlighted that in the letter sent on February 2003 by the Office of the Gas and Electricity Markets (OFGEM, energy regulator for gas and electricity in Great Britain) to the European Commission Vice President for Transport and Energy, within the context of the Ruhrgas' acquisition by German utility E.ON (a transaction analyzed and cleared under the German merger control, that will be further analyzed in this section), the British regulator already touched on the need of a convenient interaction between regulation and competition law, asserting that "*a competitive single market can only be realised if an appropriate market structure exists with appropriate regulatory and competition policy regimes applied at the national and European level*".

See also PETER CAMERON, LEGAL ASPECTS OF EU ENERGY REGULATION, 34 (Oxford ed., 2005). On the political front, see the speech of Neelie Kroes, the former EU Commissioner for Competition, The interface between regulation and competition law, 28 April 2009.

[106] Directive 2009/72 of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, art. 47.

as well as on the effectiveness of the unbundling provisions contained in the new legislation reflect poor signals of accomplishment.

In that sense, once that the three consecutive energy packages have laid down some of the milestones of the liberalization and integration processes and, hence, the seeds of the competitions are ready to thrive, merger control enforcement might become the key to avoid future failures of the sector-specific regulation. For the sake of a proper analysis of the role and challenges of the merger control in those processes, it is convenient to look first at the EU merger control rules, its evolution through the last six years and its enforcement within the electricity market.

a. Development of the EU merger control and jurisdiction of the European Commission

As a matter of fact, the EU merger control has undergone an important transformation in its approach to merger operations in the last six years. In fact, in 2004 the European Commission culminated its review of the EU merger control rules, a process initiated years before as a reaction to a series of judgments of the European Court of Justice (ECJ) overruling some of the European Commission’s decisions on merger operations[107] –and probably also due to an internal evolution tending to bestow the Commission’s economic analysis of merger operations with a greater weight.[108]

[107] While the Case No. T-342/99, Airtours v. Commission meant in 2002 the first sentence of the former Court of First Instance annulling an European Commission decision on merger operations, several rulings followed the same path (Case No. T-5/02, Tetra Laval BV v. Commission 2002; Case No. T-310/01, Schneider Electric SA v. Commission (2002)).
See ROGER J. VAN DEN BERGH AND PETER D. CAMESASCA, EUROPEAN COMPETITION LAW AND ECONOMICS: A COMPARATIVE PERSPECTIVE, 3 (2006).
See also EDURNE NAVARRO ET AL., MERGER CONTROL IN THE EU, 4 (Oxford ed., 2d ed. 2005).
In this respect, it is to be reminded that, according to the article 16 of Regulation 139/2004, the Court of Justice can issue opinions in appeal to the decisions undertaken by the European Commission. Indeed, that provisions establishes that the Court of Justice “*shall have unlimited jurisdiction “(…) ”to review decisions whereby the Commission has fixed a fine or periodic penalty payments; it may cancel, reduce or increase the fine or periodic penalty payment imposed*”.
[108] Navarro et al., *supra*. 107.

Prior to the modernization of the EU merger control that crystallized through the enactment in 2004 of the Regulation 139/2004 as well as the set of guidelines on the assessment of horizontal and non-horizontal corporate concentrations[109], the analysis of mergers and acquisitions undertaken by the European Commission relied on the scrutiny of the merging companies' market shares in order to determine whether or not an operation should be approved. In fact, according to the former Regulation a merger would be prohibited when it "*creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it*".[110]

Regardless of the rights and wrongs of the previous test and the reason that caused the move, the European Commission passed from a predominantly dominant test to a more economics-based analysis in which considerations in terms of competitive effects on consumers and efficiency gains are taken into account (commonly known as "SIEC test").[111] Specifically, the wording of the Regulation 139/2004 establishes that "[a]*concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market*".[112]

As it has been advanced in previous sections, while this test brought the EU merger control together with other international wide-used standards employed to assess merger operations (and more particularly to the "substantial lessening of competition

[109] For a comprehensive compilation of the EU rules applicable to merger control, see handbook published by the European Commission on 24 August 2009.
[110] Article 2 of Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, as amended by Council Regulation No 1310/97 of 30 June 1997.
[111] See Paper Mike Walker, "*Have the economic approaches to merger control in the EC and US converged?*", Global competition Review (2005).
[112] Art. 2.3 Regulation 139/2004.

test”[113]-SLC- used in the US), the SIEC test keeps in a way some of the features of the old dominance test. However, it broadens its scope in order to include, for instance, the analysis of the “*consequences that concentrations in oligopolistic market structures may have*”.[114] It therefore turned out, as it has been defined by different commentators[115], a kind of hybrid between the SLC and the dominance test. A further detail on the application of this sort of mechanism of presumptions upon which the DG Competition adopts its decisions on mergers is provided later in this section.

For the moment, and given the abovementioned increasing importance of merger control as a supplementary tool contributing to the achievement of some of the goals of the third energy package, we will start discussing where the power of reviewing mergers in the electricity sector remains and what authority would ideally be in a better position to assess these issues in the EU arena.

When it comes to the powers of the European Commission to analyze merger operations within the electricity markets, it is necessary to bear in mind the thresholds set by the Regulation 139/2004 to define mergers with “Community dimension” (that is to say, transactions that will fall under the exclusive jurisdiction of the European Commission).[116] Indeed, by means of these specific thresholds, the Regulation aims at

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[113] Art. 7 Clayton Act and Horizontal merger Guidelines.
[114] Recital 25 of Regulation 139/2004.
[115] For instance see Neil Horner, European Law, *Unilateral Effects and the EC Merger Regulation – How The Commission Had its Cake and Ate it Too*, 11 (2006); as well as Navarro et al, *supra*. 110.
[116] Article 1 of the Regulation 139/2004 defines the scope of the transactions that are subject to the EU merger control as follows: "[a] *concentration has a Community dimension where: (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5 000 million; and (b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State*". (Emphasis added).
Article 1.3 further establishes that "[a] *concentration that does not meet the thresholds laid down in paragraph 2 has a Community dimension where: (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2 500 million; (b) in each of at least three member states, the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million; (c) in each of at least three member states included for the purpose of point (b), the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million; and (d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100*

clearly delimiting the mergers analyzed by the European Commission from the operations subject to the scrutiny of national competition authorities, minimizing the potential conflicts of competence that might arise in this field. This was in fact the objective of the lawmaker when pointing out in Recital 8 of the Regulation 139/2004 that:

> "*The provisions to be adopted in this Regulation should apply to significant structural changes, the impact of which on the market goes beyond the national borders of any one Member State. Such concentrations should, as a general rule, be reviewed exclusively at Community level, in application of a 'one-stop shop' system and in compliance with the principle of subsidiarity. Concentrations not covered by this Regulation come, in principle, within the jurisdiction of the member states"*.

Against this backdrop, the above-mentioned rule on the thresholds that must be reached in order for a merger to have a Community dimension[117] foresees an exception to the jurisdiction of the European Commission. Indeed, even if the general turnover thresholds are met, the operation no longer will be qualified as having a Community dimension if each of the undertakings concerned in the operation "*achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State*"[118] (hereinafter, the "Two Thirds Rule"). Thus, operations where large merging companies carry out the main bulk of their business in one Member State shall fall under the jurisdiction of the relevant national competition authority.

While the purpose underlying this Two Thirds Rule exception seeks at establishing a rational framework whereby operations which are clearly focused on one Member State are overviewed by the closest competition authority, the outcome in the electricity and gas arena can certainly be unfortunate. As stated in a recently published

million (…)".
Additionally, recital 17 of Regulation 139/2004 determines the exclusive competence of the European Commission in applying that Regulation.
[117] Unlike the systems set in other jurisdictions (see for instance UK system), the EU approach does not require a preliminary analysis of the relevant market.
[118] Art. 1.2 and 1.3 of Regulation 139/2004.

report issued by the European Commission[119], in the period comprised between 2001 and 2007, the Two Thirds Rule applied in 126 cases, mainly with regard to some of the largest Member States (particularly France, Germany, Italy and Spain) with approximately 10% of the cases being related to the energy sector. In this respect, there is a twofold risk steaming from this exception. On the one hand, as the European Commission has repeatedly pointed out, because of the application of the Two Thirds Rule, operations with potential cross-border effects might escape its scrutiny.[120] On the other hand, the European Commission’s concerns resulting from that lack of authority have been exacerbated due to the bias shown by some Member States, favoring their own interests when scrutinizing mergers in the energy field.

The former source of risk has been expressly asserted by the European Commission, stating that the extent to which “*some of the transactions between large firms falling under the two-thirds rule are capable of having a significant impact on market structures and on competition beyond the confines of a single Member State*” is easily appraised.[121] According to the European Commission’s reasoning -with which this paper agrees-, a merger involving national markets that, due in part to the existence of a high level of concentration and entry barriers, become increasingly foreclosed after the transaction, may have a “*de facto*” community relevance. However, that given operation, provided that the merging companies achieve more than two-thirds of their aggregate Community-wide turnover within one Member State, would lack a “Community dimension”, and therefore would escape the scrutiny of the European Commission.

[119] Staff working paper accompanying the Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, 30 June 2009.
[120] Communication from the Commission to the Council “Report on the functioning of Regulation No 139/2004”, (June 2009) p.6.
[121] Staff working paper accompanying the Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, (30 June 2009) p 20.

In this regard, the electricity industry is a good illustration of a market where relevant geographic scope remains national[122], triggering the jurisdiction of the national competition authorities.[123] One of the main reasons why the geographic scope of the electricity markets remains national can be traced in the still poor level of cross-border interconnection between Member States. Interestingly, this factor has been repeatedly highlighted by the European Commission during the legislative process that has led to the approval of the third energy package analyzed in previous sections.[124] While the European Commission has launched several initiatives in order to address the lack of interconnection capacity between Member States[125], it is not likely that in the short term the geographical scope of these markets vary, evolving towards a wider dimension than national.

Anyhow, regardless of the particular features that cause the electricity markets scope to remain national, cases such as the merger operation between E.ON and Ruhrgas that, by means of the Two Thirds Rule, was dealt by the German Competition Authority in 2001, or the attempted take-over of Endesa by Gas Natural in 2005 -subject to the Spanish merger control rules-, are examples of transactions in the energy sector

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[122] The activities related to the generation and wholesale supply of electricity are for the most part national in their scope (see for instance, case No COMP/M.5171 - ENEL / ACCIONA / ENDESA). A few exceptions (e.g. Scandinavian markets) exist though. Moreover, transmission and distribution, being characterized as natural monopolies, usually have a regional scope.

[123] This is in spite of the efforts that some public authorities, particularly the European Institutions, have made in order to eliminate entry barriers and promote market integration. The Communication from the Commission to the Council and the European Parliament "Report on progress in creating the internal gas and electricity market", 7 (11 March 2009) refers to the disparities in prices for household consumers in the Member States in the first half of 2008 as a clear sign of insufficient market integration.

[124] Thus, for instance, congestions in the network as well as other sort of technical shortcomings (such as lack of co-ordination between national energy networks operators in issues like congestion management) prevent –or at least limit- new entrants from resorting to electricity imports as a tool for competing in prices in the retail market. See Impact assessment accompanying the legislative package on the internal market for electricity and gas (third package), 15(2007). See also MARTHA M. ROGGENKAMP,ULF HAMMER, EUROPEAN ENERGY LAW REPORT II, 26 (2005).

[125] Amongst others, the expected infrastructure increasing the interconnection between Spain and France. Indeed, an agreement aimed at doubling the electric interconnection capacity between France and Spain is going to be deployed pursuant to an agreement reached in 2008 and highly encouraged by the European Commission. Further projects with regard to the energy interconnections are to be developed according with the Trans-European energy networks (TEN-E) initiative launched by the European Commission. See: http://ec.europa.eu/energy/infrastructure/tent_e/ten_e_en.htm

with potential cross-border effects in the Community that have escaped to the analysis of the European Commission.[126] Indeed, merger operations with “community relevance” (significant spillovers that do not always have to coincide with the size of the transaction) might be out of the scope of competence of the European Commission if the operation lacks of “Community dimension” –calculated according to the turnovers reached by the merging companies-.[127] In this respect, some authors have argued that, in order to avoid distortions in the competition resulting from an inappropriate enforcement of merger control rules by Member States, the determination of the supervisory body that will scrutinize a merger operation should be defined by “the absolute size of the spillovers” (that is to say, by the effects in the markets) rather than by the turnovers reached in a given Member State.[128]

Not surprisingly, the European Commission has tried on several occasions to increase its scope of competence by filing amendment proposals of the Merger Regulation (including an attempt to drop turnovers thresholds and to add qualitative criteria to the existing quantitative standards) leading to ensure its jurisdiction every time that a transaction significantly affects competition.[129] In a recently published report, the European Commission, again, put forward a review of the Two Thirds Rule as a result of the diverting interests taken into consideration by some national

[126] Staff working paper accompanying the Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, 20 (30 June 2009).
[127] Under those circumstances, decisions of the Member States on merger operations with cross-border effects cannot be currently subject to EU review except for those cases where EU legislation is proved to have been infringed; in such circumstances, even if an infringement procedure could be initiated by the European Commission in order to challenge a concrete piece of national legislation, the decision over the merger operation taken at a national level will not be directly reversed by the European Commission. Moreover, even if a decision of a national regulatory or competition authority is finally challenged by the European Court of Justice on the grounds of the violation of EU legislation, the time-consuming process will most likely prevent this option from being an effective tool for the European Commission to review a merger with cross-border effects.
[128] D. Neven, R. Nuttall and P. Seabright, *Merger in Daylight: the economics and Politics of European Merger Control*, 198 (1993).
[129] See EDURNE NAVARRO ET AL., MERGER CONTROL IN THE EU, 68 (Oxford ed., 2d ed. 2005). European Commission’s Green Papers on the review of EU merger control (1996 and 2001).

competition authorities when analyzing merger operations that were subject to their jurisdiction as a result of the mentioned rule.[130]

For the time being, in the absence of a clear political will to step in and promote a change of the turnover thresholds and/or the Two Thirds Rule, the European Commission's scrutiny of mergers with community relevance (but not the Community dimension that triggers exclusive jurisdiction of the European Commission) would only be achieved by means of efficient referral mechanisms between the national and the Community authorities.[131] However, the current existing scheme provided by the Regulation 139/2004[132], in addition to being cumbersome in terms of the paper work required[133], does not ensure the allocation of cases to the European Commission. Indeed, given that the decision of referring cases remains at the discretion of the pertinent Member States, chances for the European Commission to be left out of the analysis of operations with significant cross-border effects but without "Community dimension" remain high.[134] In practice, as a result of the Two Thirds Rule and the

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[130] Communication from the Commission to the Council, Report on the functioning of Regulation No 139/2004, 5 (2009).

[131] Staff working paper accompanying Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, p. 66.

[132] Article 4.5 of the Regulation 139/2004, related to the prenotification referral, foresees that an operation which does not have a Community dimension, but is capable of being reviewed under the national competition laws of at least three Member States, might be subject to the scrutiny of the European Commission provided that:

- The filing company, before any notification to the competent authorities, informs the Commission that the concentration should be examined by the European Commission.
- After transmission of the request to all Member States, no Member State competent to examine the concentration under its national competition law expresses its disagreement as regards the request to refer the case within 15 working days of receiving the reasoned submission.

A similar procedure to request a referral once the notification has already been filed to one or several Member States has also been set by means of Article by article 22 of Regulation 139/2004. This "Dutch clause" (its name stemming from the need of Member States that at the time of being passed the legislation lacked from Merger Regulation), allows Member States to refer to the European Commission the analysis of transactions that do not have a Community dimension but affects trade between Member States and threatens to significantly affect competition within the territory of the Member State or States making the request.

[133] ROGER J. VAN DEN BERGH AND PETER D CAMESASCA, EUROPEAN COMPETITION LAW AND ECONOMICS: A COMPARATIVE PERSPECTIVE, 428 (Thompson ed., 2006).

[134] Even if the cooperation between national and EU competition authorities has significantly increased over the last years, such collaboration has been developed more noticeably in the field of antitrust rather than in the merger control area. See "Regulation 1/2003 on the implementation of the rules on

particular features of the electricity markets, a vast majority of mergers operations within the electricity sector has been subject to the analysis of the national competitions authorities.[135]

In addition to the jurisdictional issue, the European Commission has shown its concern about the narrow national-based approach that Member States have undertaken in some cases when analyzing merger operations in the electricity sector.[136] Indeed, the analysis of mergers such as the two transactions pointed out before (E.ON/Ruhrgas and Endesa/Gas Natural) lacked from a purely competition-based approach. In the operation analyzed by the German Bundeskartellant as well as in the attempted take-over of Endesa (first electricity incumbent in Spain in the generation, distribution and supply markets) by Gas Natural (leader in the whole chain of the gas business) subject to the scrutiny of the Spanish merger control rules, the competition authorities decided to prohibit the operations disregarding the remedies proposed by the merging companies. In the German case, where E.ON –major electricity operator- was to acquire Ruhrgas - the largest German grid gas company- the Bundeskartellamt considered that "*the*

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competition laid down in Articles 81 and 82 of the Treaty". Under its chapter IV, the Regulation foresees the application of the "*Community competition rules in close cooperation between the European Commission and the national competition authorities*". For more information on the cooperation between National Competition Authorities, see "*Co-operation between National Competition Agencies in the Enforcement of EC Competition Law*" Silke Brammer (Hart Publishing, June 2009).

[135] For a review of the transactions undertaken in the electricity field, see Arndt Christiansen, Regulation and EU merger Control in the liberalized electricity sector, (2005). See also "Mergers and acquisitions in the European electricity sector- cases and patterns", Cerna, (July 2003).
In the same context, see "Competitive Policy and Merger Analysis in Deregulated and Newly Competitive Industries: Mergers in deregulated or newly competitive industries in the European Union- energy, financial services and airline transportation" Susan Beth Farmer (SSRN, 2008).

[136] The staff working paper accompanying the Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, 30 June 2009, points out that "*public interest considerations other than competition policy have been applied in a number of cases falling under this threshold to authorise mergers which could have given rise to competition concerns*". Notwithstanding this, the potential bias in the Member State's outcome about a merger frequently arises as a result of a decision taken at a political level, and not necessarily by the competition agency. In this respect, it is necessary and fair to recognize the important role played by the national competition authorities when scrutinizing merger operations as well as, in general terms, their work in the development of a "culture of competition" in the Member States.

merger would have strengthened dominant positions both in the gas and electricity sales markets". [137] Particularly, the president of the Competition Authority stated that

> "*the combination of E.ON and Ruhrgas in a time of emerging liberalization in the gas markets would cement Ruhrgas' dominant position. This would considerably diminish the likelihood of any effective competition from other grid gas companies. There was also the danger of E.ON's market position in the electricity sector being further strengthened to the detriment of small competitors and consequently consumers.*"

Likewise, the former Spanish "Tribunal de Defensa de la Competencia" did not give the green light to the acquisition of Endesa by Gas Natural, based on similar grounds.[138] Notwithstanding this, both the German and Spanish government in office at the time when these operations took place eventually decided to authorize the mergers on the basis of the strategic significance of the prospective national energy companies resulting from those transactions.[139]

Although the study of the rights and wrongs of the trend followed by some Member States promoting the so-called energy "national champions" goes beyond the scope of this paper, it is to be noted that the European Commission has taken action to try to avoid conducts of Member States that might compromise the consecution of the Internal Market.[140] As later stated by the former Commissioner for competition, the

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[137] See Bundeskartellamt decisión:
http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2002/2002_01_21.php
For a further analysis of this decision and its consequences, see Ines Zenke, Becker Büttner Held, "*The merger of E.ON and Ruhrgas: A never-ending story?*", Volume I, issue 01, (OGEL, January 2003).

[138] See Dictamen del Tribunal de Defensa de la Competencia on this case (January 2006).

[139] See François Lévêque "*Antitrust Enforcement in the electricity and gas Industries: Problems and Solutions for the EU*", Cerna (2005/6), arguing about the need of eliminating the "Two Thirds Rule" as a result of its unsuitability to the energy sector and possible negative consequences that decisions as the ones occurred in the E.ON/Ruhrgas and Gas Natural/Endesa cases might have for the consecution of the EU competition and energy policies.

[140] In the case of the foregoing failed transaction between Endesa and Gas Natural, short time after the merger was approved by the Spanish government, an attempted counter-bid launched by the German energy giant E.ON for Endesa was subject to certain conditions imposed by the Spanish Energy Regulator (CNE). This time, given that the merger had a Community dimension due to the geographic distribution of E.ON's turnover, the European Commission asserted its sole jurisdiction over the transaction. Accordingly, it declared that the conditions imposed by Spain were in violation of article 21 of the Merger Regulation 139/2004, constituted unjustified restrictions to the merger and therefore were incompatible with Community law. This decision of the European Commission was subsequently uphold by the European Court of Justice. Case C-196/07, Judgment of the Court (Third Chamber) of 6 March

European Commission has had to legally deter Member States from “*preventing cross border mergers on unjustified grounds favoring national champions to the detriment of internal market principles*”.[141]

As a matter of fact, the most common patterns in promoting energy national champions by Member States have consisted of, first, giving thumbs up when national companies were seeking approval to create a national energy giant –in spite of the possible consequences that the operation might entail in terms of limiting the number of competitors in both overlapping markets and markets in which any of the merging companies might have become in the mid-term a possible competitor-; and, second, by deterring foreign companies from entering the national market through takeovers of relevant national entities –even if the operation could bring clear efficiencies and benefits for the consumers-. Whether such “protectionist” conducts arise as a result of the initial unwillingness of some Member States to liberalize the energy markets[142] or just owing to economic (but more plausibly strategic) reasons, remains an issue to be discussed separately though.[143] In any case, the European Commission recognized, as

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2008— Commission of the European Communities v. Kingdom of Spain
In this respect, it should be noted that article 21 of Regulation 139/2004 provides that the European Commission will have exclusive jurisdiction over takeovers with Community dimension and, accordingly, “*[n]o Member State shall apply its national legislation on competition to any concentration that has a Community dimension*”. However, that provision also adds that “*[m]ember States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law.*” Accordingly “*[p]ublic security, plurality of the media and prudential rules*” have been set in the Regulation as legitimate interests. Conversely “*[a]ny other public interest must be communicated to the Commission by the Member State concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken.*”

[141] Neelie Kroes -former European Commissioner for Competition Policy-, Developments in competition policy Meeting with the European Economic and Social Committee, Internal Market Section Brussels (9 September 2009).

[142] See infringement procedures instituted against numerous Member States for lack or inadequate implementation of the electricity and gas Directives.

[143] In this respect, see Remarks of Deborah Platt Majoras, U.S. Federal Trade Commission Chairman on “National Champions: I Don’t Even Think it Sounds Good” at the International Competition Conference/EU Competition Day (Munich, March 26, 2007), refuting the suitability of the promotion of “national champions” for the sake of industry development and general interest of consumers.
Likewise, see Speech of the Neelie Kroes on “Cross-border mergers and energy markets”, Cernobbia, Italy (2 September 2006).

the president of the Bunderskartellamt did, the threats that, in terms of undesirable effects for European competition, might involve merger operations between large national energy companies in markets still under an ongoing process of liberalization or where "*barriers between member states are being progressively eliminated*".[144] Thus, while the consolidation of strong market position by former monopolies may lead to the replication of ills of the past, the promotion of high levels of concentration through merger operations paves the way for exercising market power in the electricity field, constituting entry barriers and hampering the consecution of liberalization and EU integration goals. Indeed, precisely when the geographic scope of such markets "should" evolve towards a European-wide dimension, the high level of concentration might be pulling the triggers to counteract that tendency.[145]

Thus, in cases where cross-border effects are likely to arise, it appears that the European Commission would be placed in a better (or at least more impartial) situation for carrying out the related investigation and pursuing the merger analysis in order to ensure that the Internal Market is not jeopardized. The issue at stake is not that non-competition concerns (e.g. security of supply) should be barred from the analysis of a competition authority analyzing a merger operation, but just that, if some other variables should enter the equation of the merger control enforcement, the European Commission will probably adopt a less dogmatic position than the approach undertaken by Member States.

[144] See Staff working paper accompanying the Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, point 69 (30 June 2009).
[145] *Id.* at point 65.
The concerns showed by the European Commission related to the application of the Two Thirds Rule have been even shared by some stakeholders, as pointed out by the European Commission in its recently published Report on the functioning of Regulation No 139/2004. Some market players highlight that the European Commission is in a better position to assess certain mergers which might increase the foreclosure of specific energy markets. They hence point out the risk of a biased application of national merger control rules when analyzing transactions of strategic importance for the Country concerned.

Having explored some of the detrimental effects of the Two Thirds Rule, one might certainly cast doubts about the convenience of maintaining a rule that deprives the best positioned actor from evaluating the appropriateness of cross-border operations. Indeed, in spite of the unquestionable job made by national competition authorities promoting competition in the electricity markets, letting Member States rule about certain energy-related mergers and corporate acquisitions where national companies are involved has become the same as appointing Spanish referees should Spain played the final of the FIFA World Cup 2010. In this respect, the European Commission has highlighted in several occasions that it would be advisable to guarantee the *"protection of undistorted competition"* regardless the authority that undertakes the merger analysis.[146] However, the actual facts and outcomes emerging in the framework of some merger-related decisions –coming from all latitudes of the European Union- show that the European Commission's expectations are not always met.

Against this backdrop, several alternatives might be undertaken in order to avoid unwilling consequences in terms of competition. In this respect, the elimination of the Two Thirds Rule, at least when it comes to its application to the energy sector, appears to gain some weight[147], as this rule is being considered a significant factor for the consolidation of the national champions trend. In fact, it may be hampering one of the main goals of the EU Energy policy, namely, the integration of the electricity and gas markets. As it has been previously pointed out, the Commission itself has called to a debate on this possibility. However, although this path might be an option, other alternatives –some of them perhaps more balanced-, should be reviewed.

[146] The staff working paper accompanying the Communication from the Commission to the Council Report on the functioning of Regulation No 139/2004, Point 82(30 June 2009).
[147] See amongst others François Leveque, "Antitrust enforcement in the electricity and gas industries: problems and solutions for the EU" (Cerna, 2006).

First, at least theoretically, a different scheme to address the allocation of cases between the European Commission and the national competition authorities could pass by, precisely, not allocating cases. That is to say, applying a system akin to the US approach when it comes to the distribution of powers in merger control. According to that system, rather than a threshold that determines whether a concentration shall be analyzed under one or another regulatory body at the federal or state level, transactions of a minimum size have to be notified to the U.S. federal antitrust agencies, the U.S. Department of Justice and the Federal Trade Commission, as well as to the corresponding state competition and regulatory authorities. Under this approach, any of these authorities may, if considered necessary, challenge an operation regardless of the fact that other competition agency (even one of broader scope) may have previously cleared the merger. While implementing such a system at the European level would obviously have the virtue of ensuring that the operation is subject to all levels of scrutiny, it would be in exchange for significant amounts of time and money spent at the expense of taxpayers and private market players. Additionally, this option would most likely clash with many Member States’ standpoints as well as with the perspective of the European Commission itself on the one-stop-shop review system.[148]

At present, apart from the system of voluntary referral previously mentioned, the European Commission holds exclusive jurisdiction to analyze mergers with a Community dimension. This system avoids parallel jurisdictions, bringing cost-savings and consistency in the decisions.

Furthermore, while assuring the European Commission jurisdiction over mergers with cross-border effects, a multijurisdictional overview of merger operations would not

[148] Indeed, from the very beginning EU merger control supported the idea of one-stop-shop in the transactions with Community dimension, avoiding parallel jurisdictional disputes. See Van den Bergh and CAMESASCA, EUROPEAN COMPETITION LAW AND ECONOMICS: A COMPARATIVE PERSPECTIVE, 427 (Thomson, 2006).

bar Member States from blocking operations that might be beneficial (or at least not harmful) for the achievement of the European integration and liberalization. For all these reasons, the implementation of this option at the EU level should be clearly dismissed.

Second, greater chances of "appropriate" application of competition rules could be achieved should the national authorities responsible for the control of mergers and acquisitions were given real independence from their corresponding national governments. Such an option at least would contribute to ensure alike application of merger control across the EU. Nevertheless, this option would still not attribute to the European Commission competence over all mergers with cross-border effects. Moreover, in spite of the fact that the independency of administrative bodies is a commendable objective sought by the European Union[149], its implementation would necessarily entail thorough amendments of the different national procedures set for the analysis, and potential clearance, of merger operations.

Thus, for this alternative to effectively mitigate undesirable bias, it would be necessary that the Member States would commit to guarantee not only that both national competition agencies and sector-related regulators taking part in the supervision of merger operations in the electricity sector are effectively independent[150], but also that the whole procedure of analysis in every single Member State does not give room for political discretion. And, in this regard, even the countries with the longest tradition in

[149] As it has been mentioned before in this paper, the European Commission has stressed the need for an equal enforcement of competition standards EU-wide. When it comes to the role of National Regulatory Authorities, see chapter IX of the Directive 2009/72, related to, amongst other aspects, the required level of independence of these administrative bodies.

[150] In the abovementioned cases regarding Gas Natural/Endesa, when E.ON bid for Endesa, the National Regulatory Authority (CNE) was the administrative body which introduced the conditions that eventually led the German company to withdraw its offer. The final reversal by the European Court of Justice –one year later- of the Spanish legislation that enabled the CNE to impose those conditions obviously did not bring a relief to E.ON.

the application of merger control enforcement (as it might be the case of Germany in the European Union landscape), preserve in their legislation the option for a “political” final say about a transaction.[151]

Finally, an alternative that would indirectly grant the European Commission a control over mergers with potential cross border effects might have been hinted by the former commissioner for competition Neelie Kroes when she affirmed that a modification of the current EU merger rules could be necessary in order to ensure “*that merger cases get the same strict investigation everywhere, be it at national or European level*”.[152] Thus, the variation from the current system would mainly involve a sort of European Commission’s power of review over the decisions taken by the national competition authorities on mergers, at least those potentially leading to cross-border anticompetitive effects.

In this regard, in order to minimize the undesirable uncertainties derived from an outright overview of national decisions over mergers,[153] this alternative would consist of keeping the current Two Thirds Rule as a matter of initial approach in the allocation

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[151] Indeed, though rarely used, the German executive power holds the competence to overrule the decisions taken by its national competition authority on the grounds of policy reasons, as it was the case in its decision of 5 July 2002 granting ministerial authorization to the E.ON/Ruhrgas transaction. At that occasion the reason underlying such a ministerial resolution was that “*Ruhrgas’ international competitiveness would be strengthened on the procurement side. According to the Ministry, the long-term purchase of inexpensive natural gas, particularly from Russia, will improve the security of supply in Germany*.” See Bundeskartellamt report 2001- 2002, pg 13.
Any imposition of modifications on these areas by the European Commission (removing unreasonable discretionary power by politicians in the context of merger transactions), would be probably beyond the powers of the European Union.

[152] Speech Neelie Kroes, former European Commissioner DG Competition, What’s Wrong with Europe’s Energy Markets?, Vienna, (1 March 2006).

[153]It is without a doubt that non-negligible difficulties would arise in order to define in a reasonable and legally certain way the takeovers fulfilling the characteristics in order to be overseen by the European Commission. Some of the standards to be used for clearly determining the outreach of the Commission’s power might go beyond the short-term potential cross-border effects of the transaction and, conversely, focus on the long-term consequences of the transaction for the achievement of the internal market. These consequences can actually stem from the exacerbation of some characteristics of the electricity market structures (particularly the foreclosure of the markets).
However, it seems doubtful that Member States would accept a legislative action to ensure European Commission’s jurisdiction over mergers EU-wide if that option implies a direct interference in the day-to-day work of the national competition authorities.

of jurisdiction, focusing subsequently solely on those operations which have benefited from that exception and, hence, "escape" the European Commission scrutiny. Based on the European Commission statistics[154], in the period comprised between 2001 and 2008, 126 cases fell under the Two-Thirds Rule. However, only a 10% of these cases were related to the energy sector. Accordingly, the power of the European Commission for intervening –and potentially claim jurisdiction over a merger- would be limited to a restricted number of transactions. The European Commission intervention should in any event take place before the national competition authority initiates its review of the case in order to avoid the costs, in economic and time-consuming terms, stemming from a potential reversal of a national competition authority decision by the European Commission.

In this respect, according to the European Commission, the Two Third Rule only fails in few cases to distinguish between "*concentrations that, in terms of their cross-border effects, have a Community relevance and those that do not*".[155] If this appraisal is correct, the intervention –and subsequent need for the European Commission to demonstrate spillovers of a given merger- would be reduced to a small number of transactions and the interference with the functioning of national competition authorities would be mitigated.

b. Shifting on the substantive test and results

As a result of the previous debate on the suitability of allocating the supervision of certain cross-border transactions to the national competition authorities, one might conclude that every time that the European Commission takes the lead and oversees a takeover with Community dimension, "strict" merger control will take place.

[154] Communication from the Commission to the Council: Report on the functioning of Regulation No 139/2004, European Commission, June 18 2009.
[155] *Id.*

Nevertheless, that has not been always the case. As already advanced in previous sections, the potential concerns when analyzing mergers in the electricity markets are not confined to the identity of the agency exercising the competitive analysis of the operation -and particularly whether the European Commission will have jurisdiction over a merger which displays its effects beyond the boundaries of a certain Member State-. Conversely, one additional key factor that will define the reliability of the competition analysis revolves around the aspects to be taken into consideration in order to gauge the potential anticompetitive effects of the operation –factors that, eventually, will lead the competition authority to clear, prohibit or authorize a merger subject to certain conditions-.[156]

Likewise, the effectiveness in the detection of potential competition concerns stemming from a merger does not necessarily rely either on the amount, or percentage, of transactions banned by the competition authorities. In this field, more than in any other, quality should prevail over quantity.[157]

In order to get around these and other possible flaws, a major turn on the EU merger legislation took place in 2004, by means of the approval of the new regulation 139/2004, complemented by specific guidelines on the assessment of horizontal mergers as well as through later guidelines on the assessment of non-horizontal concentrations.[158] Whether this new piece of legislation involved a real shift in the

[156] Thus, even if a given competition authority might look stricter in the application of its control over merger operations by blocking a higher number of proposed concentrations, it could occur that anticompetitive operations would be getting approved; conversely, fairly pro-competitive transactions could be blocked

[157]In this context, and from a quantitative perspective, the European Commission has undertaken the review of more than 130 mergers in the electricity sector (or involving traditionally electricity-based companies) during the period comprised between the mid 1990s and 2004. Only one of them has been eventually prohibited at the end of the two-phase review process (M.3440 - ENI / EDP / GDP (2004)). On the contrary, in a large number of cases, the takeover was approved subject to different kind of conditions –remedies- aimed at rendering the transaction compatible with the European Common Market. Indeed, arts. 6.2 and 8.2 of Regulation 139/2004 provide that the European Commission may decide, "*following modification by the undertakings concerned*", in Phase I or II, that a concentration no longer raise any doubts about its compatibility with the common market.

[158] See 2004/C 31/03, Guidelines on the assessment of horizontal mergers under the Council Regulation

European Commission approach to merger control, or was simply a “*matter of continuity rather than discontinuity*”[159], has been a subject of extended discussion; however, it cannot be contested that the new substantive test (essentially based on whether the merger will “*significantly impede effective competition*”), meant a consolidation in the evolution towards a more effects-based approach in the analysis of merger operations.

This advancement, at least theoretically, would limit the traditional structural analysis of mergers based on the market shares of the intervening companies to a mere additional criteria. Indeed, even if a high market share remains a significant factor in the analysis, it would not categorically entail the existence of anticompetitive effects and, more importantly, its absence would not automatically preclude further examination. Thus, the decision to undertake an in-depth second phase[160] investigation should be made not only upon data related to market shares or market concentration, but based on the odds for the merger to significantly impede effective competition. For that purpose, the DG Competition will carry out an analysis of the competitive conditions before and after the transaction, taking into consideration, where necessary, factors that might diminish the post-merger level of competition such as –but not limited to- strength and

on the control of concentrations between undertakings (OJEU 5.2.2004); and 2008/C 265/07, Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (OJEU 18.10.2008).

As a result of different setbacks detected by the European Commission (published in a Commission's Merger Remedy Study (2005)) in the application of some remedies approved within the framework of merger operations subject to the EU merger control (and more particularly in the divestiture of businesses), the Commission adopted a Remedies Notice in 2008 in which addresses specific requirements of the divesting approach, focusing on aspects such as the scope of the business , the profile of the buyers and the actual performance of the remedies agreed.

[159] It is noteworthy that Recital 25 of the Regulation 139/ 2004 points out that the EU merger control approach does not imply a complete rebuttal of the dominance test.

[160] In this regard, it is to be noted that the review of merger operations by the European Commission is basically divided into two main phases. According to the current Regulation 139/2004, the first phase –commencing with the notification of the operation by the parties- will consist of a period of twenty five working days at the end of which the Commission will have to decide whether the transaction causes serious doubts as to its compatibility with the common market; when that it is not the case (or the Commission just considers that the operation does not fall under its jurisdiction), the transaction will be cleared. Otherwise, the review will pass to a Phase II –90 working days subject to extensions-, where an in-depth investigation of the operation is undertaken. A further description of factors that make the European Commission opting to proceed to a second Phase are further developed in following sections.

number of competitors, existence of capacity constraints, close substitutability of merging firms products or the likelihood that other companies enter the market.[161]

In that sense, it is noticeable how the EU approach to mergers -further developed in the guidelines on the assessment of horizontal mergers- highly converges with the FTC/DOJ perspective in the assessment of these transactions.[162] Indeed, the European rules on merger control also warn against a mechanical application of the different steps set in the EU Guidelines, calling instead for a competitive analysis “*based on an overall assessment of the foreseeable impact of the merger in the light of the relevant factors and conditions. Not all the elements will always be relevant to each and every horizontal merger, and it may not be necessary to analyse all the elements of a case in the same detail*”.[163]

In the framework of the electric industry, and particularly within the context of the proposed acquisition of joint control over Hidrocantábrico by EDP, EnBW and Cajastur[164], in spite of the relatively limited market shares –not superior to 10-15%-

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[161] See Guidelines on Assessment of Horizontal Mergers under Regulation (EC) No 139/2004, point 17.
On an American approach to the importance of potential competition in assessing the effects of a merger -as well as in the context of antitrust cases- see Darren Bush & Salvatore Massa, *Rethinking the Potential Competition Doctrine*, 4 WIS. L. REV. 1035 (2004)

[162] In this context, the power to conduct inspections laid down in the merger Regulation stands out as an important tool provided to the European Commission. Particularly, the ability to require different types of documents to the merging companies resembles, to a certain extent, the DOJ civil investigative demand authority to compel information from third parties. The powers provided in art. 13 of Regulation 139/2004 authorizes the European Commission, for instance, to conduct inspections across the facilities of the merging companies, examining the books and other business-related data, interrogating employees of the companies. Fines for intentionally or negligently supplying misleading information within the course of the investigation are equally foreseen by the Regulation 139/2004 (article 14).
These approaches differ from the position of FERC in the analysis of mergers, which, in general terms, lacks of investigative tools. As previously advanced, some authors have stated that such inexistent–or limited- ability to obtain sensitive competitive information cannot be considered the reason behind the FERC’s approach to the merger review, which would be based on a particular conception of the market power in electricity markets. See, “*Electricity merger analysis: market screen, market definition and other lemmings*”, Darren Bush p.284 (Review of Industrial Organization, 2008).

[163] See Guidelines on Assessment of Horizontal Mergers under Regulation (EC) No 139/2004, point 13.
Likewise, the EU Guidelines on the assessment of non-horizontal mergers approved by the European Commission in 2008 establish that the different HHI thresholds proposed within that document cannot be taken as a legal presumption on the existence of competition concerns but just as preliminary indicators. Indeed, they specifically remind that “*the existence of a significant degree of market power in at least one of the markets concerned is a necessary condition for competitive harm, but is not a sufficient condition.*” Guidelines on the assessment of non-horizontal mergers, point 27.

[164] European Commission case M.2684 - EnBW / EDP / Cajastur / Hidrocantabrico (2002).

held by the merging parties in each of the two relevant markets concerned in this case (namely, electricity sold through the wholesale market and retail market), the European Commission decided that the transaction should be *“assessed in the light of the high degree of concentration on the Spanish electricity market and of its isolation due to a shortage of interconnections with other systems”.*[165] In this case, the concerns of the European Commission rose from the fact that EdF held joint control over one of the buyers in the operation (EnBW). As a result of the proposed merger, the European Commission feared that EdF, absolute dominant player in the generation, transmission, distribution and trading of electricity in France, lacked of incentives to increase the interconnection capacity between France and the Iberian Peninsula, perpetuating one of the most relevant entry barriers to the highly concentrated Spanish market.[166]

It is noteworthy that the analysis of this case took place under the former EU merger regulation, sustained in the test of dominance. However, it has been broadly expected that, in general terms, the move from the test of dominance to the SIEC test would result in a more efficient control. Indeed, under the test applied prior to 2004, the dominance was the factor to be proven in order to challenge the operation. It did not necessarily imply that only market shares angles would be observed, but if the merger led to relevant concentration levels the operation had significant chances to be challenged

[165] *Id.* at point 29.

[166] The definition of the relevant product markets was initially settled in the electricity market by differentiating between the generation, transmission, distribution and supply activities. When it comes to this last field, the European Commission has considered, and finally accepted according to the degree of liberalization achieved in each EU Member State, the segregation between wholesale and retail activities. Thus, the European Commission decisions in cases such as EDF/ Louis Dreyfus (M.1557 -1999); Grupo Villar Mir/ EnBW/ Hidroelectrica del Cantabrico (M.2434 - 2001); or the above mentioned EnBW/ EDP/ Cajastur / Hidrocantabrico, show how the definition of the relevant product markets (and particularly the ones related to supply activities) will vary according to the existing degree of liberalization. In that sense, in the projected acquisition of Hidroelectrica del Cantabrico by Grupo Villar Mir and EnBW taking place in Spain, the distinction between “*the electricity offered through the wholesale market (the pool and bilateral contracts between eligible customers [*-those which are free to choose among suppliers-] *and generators) and the electricity offered subsequently by traders to eligible customers (retail market)*” was made.
When it comes to the geographic scope, different factors and particularly the physical constraints (lack of cross boundary transmission capacity) and regulatory divergences between the EU countries lead to the definition (except in few exceptions mentioned before –e.g. Scandinavian markets-) of relevant geographical markets at a national level.

(involving in some cases a clear risk of over-enforcement - false positives-). Likewise, false negatives (or under-enforcement) were more likely to occur under the dominance test. In this respect, the SIEC test should be useful in order to avoid overlooking some operations that, subject to the preceding test, would have probably received approval of the European Commission.[167]

Thus, the “new” test approaches the horizontal mergers by clearly distinguishing between coordinated and non-coordinated effects which might stem from mergers. Indeed, the amendment of the substantive test sought to close enforcement gaps existing under the previous dominance test approach. [168]

On the front of non-coordinated effects, the SIEC test allows tackling oligopolistic situations where the resulting merged company unilaterally enjoys substantial market power but does not become the largest firm in the market.[169] When horizontal mergers are under the spotlight, factors such as the market shares held by the merging companies, the pre-merger competitive relationship between those undertakings, the elimination of an important competitive force in the market or the limited chances for customers to switch to another supplier, could, according to the Guideline on horizontal mergers, result in significant non-coordinated effects that might eventually lead the European Commission to challenge the operation (particularly when a combination of that factors occurs).

Other than the risks for competition stemming from unilateral behaviors – concerning either dominant firms or members of an oligopolistic market-, coordinated effects resulting from horizontal mergers are also subject to the European Commission’s

[167] See MARTHA M. ROGGENKAMP,ULF HAMMER, EUROPEAN ENERGY LAW REPORT II (2005).
[168] This point makes the difference with the previous approach, whereby mergers which did not create or strengthen a dominant position could not be challenged by the European Commission.
See also note 75.
[169] See Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03), point 24.

scrutiny. More particularly, the guidelines refer to "tacit collusion"[170] between the merging companies and the remaining competitors in the market. Indeed, the European Commission asserts that particularly in highly concentrated markets -as it is the case in the majority of segments of the electric power industry across the European Union- mergers might, under certain circumstances, significantly impede effective competition, given that they might increase

> "*the likelihood that firms are able to coordinate their behaviour in this way and raise prices, even without entering into an agreement or resorting to a concerted practice within the meaning of Article 81 of the Treaty. A merger may also make coordination easier, more stable or more effective for firms, that were already coordinating before the merger, either by making the coordination more robust or by permitting firms to coordinate on even higher prices.*"[171]

Vertical and conglomerate mergers were similarly addressed, distinguishing between coordinated and non–coordinated effects. Non-coordinated effects were particularly feared as they may result in the foreclosure of the markets to third parties.[172]

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[170] Tacit collusion between companies, which may result in coordination related to prices, volume of output or geographic allocation of markets, would differ from the more obviously reprehensible collusive agreements, subject to the prohibition of the former article 81 of the EC Treaty.
See Frank Maier-Rigaud and Kay Parplies, *EU Merger Control Five Years After The Introduction Of The SIEC Test: What Explains the Drop in Enforcement Activity?*" (European Commission Lwa Review, 2009).

[171] Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, 39 (2004/C 31/03).
It is to be noted that, in order to consider tacit collusion to be a real risk for competition, the European Commission requires the fulfillment of three conditions. These conditions match the requirements previously pointed out by the European Court of First Instance in its first judgment overruling the European Commission on a merger prohibition Case T-342/99, Airtours v Commission. Thus, the companies involved in a tacit collusion must be able to monitor the compliance by the other participants with the terms of the coordination; a mechanism of deterrence must be available to be applied to those companies which deviates from the coordinated trend; and the results derived from the coordination should not be jeopardized by other competitors or customers not participating in the coordination.
The inclusion of this coordinated effects theory within the guidelines confirms the convergence of the EU and US approaches to "coordinated effects" in the context of horizontal mergers.

[172] In order to appraise actual non-coordinated effects, three steps in the scrutiny of the merger are required by the European Commission's guidelines (analysis of post merger ability to substantially foreclose access to inputs; incentive to incur in such a foreclosure conduct; and overall likely impact on effective competition, particularly materialized through significant prejudicial impact on competition downstream or upstream stemmed from the merger operation). See section 47 of the Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (OJEU 18.10.2008).

The relevance of coordinated and non-coordinated effects stemmed from vertical merger operations can be illustrated by the European Commission decision on the acquisition of British Energy by EDF[173], analyzed under the new EU merger Regulation. In this respect, vertical mergers within the electricity markets are to be analyzed under a different angle with regard to their potential effects on competition. Indeed, contrary to the broad-shared opinion that non-horizontal mergers are "*less likely to significantly impede effective competition than horizontal mergers"*[174]*,* vertical mergers in the electricity sector can result in particularly harmful consequences.

As the European Commission reminds in the British Energy/ EDF case, the conclusions of the sector inquiry driven in the energy market already warned against mergers that increase the level of vertical integration of the merged entity, as they:

> "*can potentially lead to a decrease of the merged entity's need to trade with other counterparties in the wholesale markets since part of its power needs might, post-merger, be covered by the merged entity's own power generation. If this happens, it is possible that liquidity in the wholesale markets is reduced. The market investigation is not conclusive as to whether, in general, there is a direct link between an increase of vertical integration and a decrease in liquidity. However, the market investigation has expressed serious concerns that this particular transaction may in fact have such negative effects on liquidity*."[175]

This concern about vertical mergers must be particularly framed within the context of the new energy package approved by the European Union, and particularly regarding the unbundling alternatives set in the new directive 2009/72. In fact, should the concerns expressed by the European Commission[176] about the effectiveness of unbundling options –particularly those not entailing ownership separation- prove to be confirmed (ISO or ITO alternatives resulting in unsuccessful levels of unbundling), the control of vertical mergers will have a more significant role in the completion of the EU

[173] Case No COMP/M.5224 - EDF / British Energy

[174] See Working Party No. 3 on Co-operation and Enforcement: Roundtable on the standard for merger review, with a particular emphasis on country experience with the change of merger review standard from the dominance test to the SLC/SIEC test (OECD, 2009).

[175] Case No COMP/M.5224 - EDF / British Energy, point 40.

[176] Speech Neelie Kroes, More competition and greater energy security in the Single European Market or electricity and gas (Berlin, 30 March 2007).

energy objectives.[177]

Vertical and conglomerate effects concerns were already raised during the merger analysis that led to the prohibition of the acquisition of GDP by EDP and ENI.[178] Being the gas an important input in the generation of electricity, the European Commission deemed that the merger between the dominant gas and electricity operators in Portugal would give rise to foreclosure effects both on the gas and electricity markets.[179]

c. Incorporation of efficiency-based considerations to the EU Merger review and remedies applied in the electricity sector

Efficiency considerations in the merger review, incorporated to the European Commission analysis by EU Regulation 139/2004, deserve a specific treatment. Indeed, while the risk of "false negatives" resulting from an excessive reliance on market share and concentration considerations has been repeatedly highlighted in previous sections, the introduction of efficiency defenses in the merger review might prevent false positives. That is to say, avoid erroneous merger prohibitions or imposition of unnecessary burdensome conditions. Unlike a majority of merger review systems existing in other jurisdictions[180], the EU approach to mergers for years did not take into consideration efficiencies as a mean to counteract possible anticompetitive impacts of the transaction. Contrarily, according to the former merger regulation, efficiency gains

[177] Indeed, mergers leading to the vertical integration of electricity generation, supply and transmission activities might drive, in the absence of effective unbundling, discriminatory treatment in the access to transmission facilities and, therefore, the foreclosure of the markets and failure to achieve the energy integration market objective.

[178] Case No COMP/M.3440 EDP/ENI/GDP, decision of December 9, 2004.

[179] Likewise, the conglomerate mergers as defined by the Guidelines on the assessment of non-horizontal mergers can imply anticompetitive horizontal effects. This is the case, for instance, when a gas supplier and an electricity generator decide to merge, removing a potential competitor on the gas and electricity markets.

See, for instance Case COMP/M 493 Tractabel/Distriaz and COMP/M.3440 EDP/ENI/GDP

[180] The US approach to merger review foresees the use of efficiencies during the analysis of a transaction, but also other jurisdictions legislations such as the Canadian Competition Act (sub-section 96 (1), or the UK Enterprise Act 2002 take into consideration efficiencies that might result in customer benefits and, therefore, would offset potential adverse effects to competition. For an economical analysis of the new approach to efficiencies in the EU, see Fabienne Ilzkovitz and Roderick Meiklejohn , *European Control: do we need an efficiency defense?* (Publications Office of the European Commission, 2006).

were traditionally considered as anti-competitive signal for the competition authority reviewing the operation.[181]

The merger Regulation 139/2004 introduced, and the horizontal guidelines further developed, the notion of efficiency as a factor to be weighed by the European Commission in order to assess the overall competitive impact of a concentration. Similarly to the DOJ practice in this same field of merger defenses, the European Commission, in order to consider efficiencies as a suitable counteracting factor susceptible to offset the adverse competitive effects, will require that the alleged efficiency gains fulfill specific criteria. Specifically, efficiencies are required to pass on to consumers –benefiting them by means of lower prices and/or enhanced products offered by the merged company-, do not result in the reduction of output[182], derive from the transaction -merger-specific- and be sufficiently verifiable.[183]

The appraisal of efficiencies by the European Commission is subject to similar requirements when it comes to vertical and conglomerate mergers. Nonetheless, the EU guidelines on non-horizontal mergers[184] expressly acknowledge that this kind of vertical and conglomerate integration is more likely to lead to substantial pro-competitive efficiencies.[185] While this is indeed a common argument contended by merging companies operating in the electric industry, the existence of clear efficiencies

[181] The European Commission, prior to the enactment of the new Merger Regulation, had frequently considered efficiencies (such as the consecution of economies of scale by means of the merger) as signals of dominance existence instead of factors contributing to counteract competitive harms stemming from the transaction. See, for instance case M.2220- GE/Honeywell (merger approved, subject to certain conditions in the form of divestitures, by the US DOJ, but prohibited by the European Commission).
[182] As it is well established, reduction of costs driven by cuts in production does not bring gains for consumers in the long run.
[183] *Supra.* note 170 at point 76.
[184] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2008).
[185] For instance, the Guidelines on non-horizontal mergers refer to the "internalization of double mark-ups" frequently occurring in vertical mergers. Roughly speaking, the merging firm will have incentives to decrease prices in the downstream market given the fact that the increase in demand that this move entails will also benefit the upstream market –costs cuts, etc.-. See point 13 and 47 of the guidelines.

stemming from vertical mergers[186] should be however confronted to some of the concerns raised by the European Commission in the inquiry conducted in the energy sector. Thus, a high level of vertical integration (in principle limited by the unbundling requirements as for the transmission activity, but not restricted when it comes to generation and supply activities) can result in poor levels of liquidity, particularly if the market is highly concentrated. As a result, combination of generation (including import capacity) and supply activities discourage the merging company to participate on wholesale markets (opting preferably for bilateral contracts between divisions of the same merging firm). As it has been stated by the European Commission, low levels of liquidity in wholesale markets might result in significant entry barriers.[187]

Having said that, and notwithstanding this important incorporation to the merger analysis, the use of efficiencies as an ultimate ground to conclude that a given merger should not be blocked in spite of certain anticompetitive effects, does not appear to have gained relevant weight. The strict scrutiny applied by the European Commission and, perhaps, the still excessive reliance on market shares factors, might be the cause of the current lack of "interest" for the efficiency defense.

Finally, when anticompetitive effects arise from a merger, the European Commission may still approve the transaction subject to certain commitments, offered by the merging parties and ensured by means of conditions and obligations attached to the competition authority's decision.[188] Those elements –referred to as remedies- aim at

[186] David Newbery, *What are the Issues in Mergers and Acquisitions arising from electricity market structuring?* (Florence School of Regulation 2007), deals with the advantages and concerns stemming from the mergers in the electricity sector, pointing at, amongst others, the treatment of vertical mergers between generation and supply, as well as mergers involving gas and electricity.

[187] Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors, point 20 (Final Report) (European Commission 2007).

[188] Articles 6.2 and 8.2 of EU merger regulation 139/2004.

In October 2005, the European Commission published the "Merger Remedies Study" containing an assessment of the efficiency of merger remedies adopted in cleared mergers between 1996 and 2000. For the sake of clarity in the application of remedies in the context of merger operations –and particularly in neutralizing the potential harmful impact in competition that a given merger might involve. In this respect, even if in theory the European Commission is unable to impose conditions and obligations[189] -that will only be issued upon commitments expressed by the merging parties-, in practice, the measures proposed by the companies will have to comply with a set of guidelines published by the European Commission.

Indeed, akin to the evolution followed in the US in the application of the guiding principles issued by the FTC/DOJ[190], the European Commission has analyzed the long term consequences derived from different kinds of remedies undertaken in previous cases. Its assessment has thus focused on those conditions which most likely efficiently address different angles of competition concerns frequently arising in the framework of a merger operation. Accordingly, a company that considers entering into a merger operation that is likely to raise competition concerns should have to take into close consideration such guidance.

The election and analysis of remedies involve a high level of complexity both for the merging firms and the European Commission. Indeed, both parties (but particularly the companies) must carefully analyze those remedies that are able to neutralize possible competitive concerns while not removing the business value of the transaction. In this respect, even if commitments offered by the parties will be considered regardless

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order to clarify the kind of commitments that are likely to accepted by this competition authority-, the European Commission additionally published, in 2008, the Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

[189] The Commission notice on remedies (points 19 and 20) clearly distinguishes between the two possible outcomes of the commitments offered by the merging companies, should they are finally accepted by the European Commission. Thus, a “condition” consists of a “*requirement for achievement of the structural change of the market*” (for instance, the divestiture of a division of a company) and its infringement will render the EC approval void; conversely, an “obligation” is defined as “*the implementing steps*” necessary to achieve the final result expressed in the condition (the breach of an obligation might lead the European Commission to “*revoke clearance decisions issued*”).

[190] See “Antitrust Division Policy Guide to Merger Remedies”, U.S. Dep’t of Justice, DOJ, at 4 (Oct. 2004) and “Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies”. Additionally, for a practical comparative analysis of the different feature of the US and EU approach to remedies in the merger operations, see PRACTICAL LAW COMPANY'S CROSS-BORDER COMPETITION HANDBOOK, and particularly the chapter devoted to “*Merger Remedies Policy In The EU and USA*” (William Baer and Luc Gyselen).

the Phase of the procedure in which they are made, it goes without a say that the companies will try to avoid a time consuming in-depth phase II investigation that, in many cases, might ruin the economic purpose of the transaction.[191]

When it comes to the key features depicted by the European Commission of what a remedy should be in order to bring about the merger clearance, it stands out the complete and effective eradication of all competition concerns, and the capability of being hastily enforceable and susceptible to be monitored.[192] Moreover, although every case is supposed to be analyzed in a case-by-case basis according to its particular characteristics, the European Commission puts forward two main types of remedies, i.e. those based on structural measures and remedies based on conduct commitments.[193]

Structural initiatives –and particularly divestitures- appear to have gained the favor of the European Commission. This trend bears a significant resemblance to the approach applied by the FTC/DOJ in the review of remedies.[194] It does not result surprising, since it is broadly acknowledged that these measures require lower levels of

[191] The need for a “good first try” on the commitments proposed by the entity also relies on the fact that, as the European Commission has stated in its notice about remedies, the “*commitments submitted to the Commission in phase I must be sufficient to clearly rule out ‘serious doubts’ within the meaning of Article 6(1)(c) of the Merger Regulation*”. See Commission notice on remedies, point 18.
Conversely, should the operation passes to a second Phase review -due to the merger’s potential significant impediment of effective competition-, the demand of the European Commission for tighter remedies will increase. Indeed, commitments offered in this second stage *“must be sufficient to eliminate such a significant impediment to effective competition”*.
In this respect, it is to be noted that, regardless the “quality” of the commitments proposed by the merging companies, the European Commission keeps the burden of proof when it comes to the task of demonstrating that the transaction, after consideration of the remedies proposed is still not compatible with the common market. The merging companies, as far as they are concerned, remain responsible “*to provide all such information available that is necessary for the Commission's assessment of the remedies proposal.”* See Commission notice on remedies, point 7.
[192] See Commission notice on remedies, section II.
[193] For a further explanation on types of remedies and their suitability when it comes to the electric industry, see DAMIEN GERADIN, REMEDIES IN NETWORK INDUSTRIES: EC COMPETITION LAW VS. SECTOR-SPECIFIC REGULATION (Intersentia, 2004).
[194] However, slight differences exist between the FTC and DOJ when it comes to the implementation of the conditions finally settled–mainly consisting of the preference of the FTC to tie up the details related to the divestiture before the issuance of the final consent order-. For further information about the application of remedies to mergers at both sides of the Atlantic, see the chapter devoted to Merger Remedies Policy in the EU and USA (William Baer and Luc Gyselen) in PRACTICAL LAW COMPANY'S CROSS-BORDER COMPETITION HANDBOOK (2006/07).

supervision than the overview needed by behavioral commitments. Additionally, structural measures generally address in a straightforward manner competition concerns that arise from mergers.[195] Thus, in cases such as the acquisition of Suez Group by Gaz de France[196], the European Commission, fearing substantial harms for competition in the French gas markets as well as in the Belgian gas and electricity wholesale and retail markets, conditioned the approval of the operation to a comprehensive package of remedies. Most of these remedies were based on structural actions including, amongst others, relinquishment of control over Belgian gas network operator; divestitures of the shareholdings of Gaz de France in electricity markets in Belgium –SPE-, as well as the sale of the main gas subsidiary of Suez –Distrigaz- in an effort to preserve competition in a field highly dominated by the state-owned giant Gaz de France. [197]

This type of commitments, however, suffers from some flaws. Indeed the implementation of structural remedies by means of a divestiture presents numerous intricacies -not always easy to resolve[198]- which might undermine the actual effectiveness of the proposed measures. As it will be noted, the following weaknesses may not automatically disqualify these commitments, but they should be borne in mind by the competition authorities before taking a clearance decision based on those conditions.

[195] Commission notice on remedies, point 15. See also Richard J. Gilbert and David M. Newberry, *Electricity Merger Policy in the Shadow of Regulation* (Energy Policy and Economics, October 2006), where the authors remind that the "*US experience of the workings of the Federal Power Act suggest that regulation to inhibit market power is likely to involve continuous monitoring of deregulated electricity markets*", finally concluding that "*the Californian evidence might suggest that any behavioural remedy to address the abuse of market power in deregulated electricity market would be more burdensome for the undertaking concerned than the structural remedy.*"

[196] Case M.4180 - Gaz de France / Suez (2006)

[197] It is noteworthy that a form of divestiture commonly used in energy mergers has consisted of the sale of shareholding participations in energy related companies. Apart from the Gaz de France/ Suez case already mentioned, see, amongst others, case M.1673 - VEBA / VIAG and case M.2947 - VERBUND / Energie Allianz.

[198] For a more detailed analysis of the potential shortcomings of a divestiture alternative to mergers, see Penelope Papandropoulos and Alessandro Tajana, *The Merger Remedies Study—In Divestiture We Trust?* (ECLR, 2006).

First, the European Commission requires that the divestiture may create "*the conditions for the emergence of a new competitive entity or for the strengthening of existing competitors via divestiture by the merging parties*".[199] To that end, such an entity must consist of a "*viable business*" being able to autonomously operate on a long-term basis. While the European Commission is clearly more sympathetic to divestures of a business division "*which was not previously legally incorporated as such*"[200], carve-outs[201] of divisions integrated in the structure of the business that is going to be retained are also admitted if no other alternative is feasible.

In this respect, and particularly in the electricity sector, the viability of a business division susceptible to be divested is often tied to an ancillary service that, at the same time, might be essential for the development of the retained business. Indeed, for instance, the trading division of an electric company might be as important for the branch to be divested –e.g. electricity retailing activity- as it is for the retained business –e.g. power generation, heavily dependent on trading activities-. Accordingly, the latter might legitimately contend that the trading division, being an essential part of its business, should be retained by the merging entity. Even if the European Commission has tried to address potential disputes regarding the allocation of assets to the divested business[202], it frequently results complicated to determine the concrete assets that are indispensable for the development of one or the another division. Hence, merging companies will for the most part try to keep the best assets "onboard" (including key employees), giving rise to controversies within the framework of the divesting

[199] Commission notice on remedies, point 23.
[200] Commission notice on remedies, point 33.
[201] The European Commission defines a carve-out in its Merger Remedies Study (2005) as "*the legal and physical separation of the assets of the divested business from the parties' retained business, so that the divested business can operate on a stand-alone basis, which can compete successfully on a lasting basis independently of the divesting parties*."
[202] Commission notice on remedies, points 25 and 26.

procedure or, if not detected by the competition authority, to a doomed to failure divested division.

Second, but closely related to the previous factor, the suitability of a potential purchaser of a divested business should be meticulously analyzed in order to avoid that indirect effects of the very transaction –in the form of divestitures- result in anticompetitive effects in the relevant market.[203] The typical oligopolistic panorama of the electricity markets frequently makes difficult the task of selecting an appropriate company that could face the challenge of incorporating the divested business resulting from a merger without provoking more worrying competitive concerns than those that the remedy purports to mitigate. Indeed, the risk of collusion must definitely remain a source of concern whenever remedies are analyzed in the framework of a merger, particularly in the electricity industry as a result of some of their specific features briefed in previous sections (high degree of concentration, limited capacity, inelasticity of demand, etc.). Accordingly, the European Commission, consistent with the final goal set forth by the SIEC test, should primarily focus not just on the market shares held by the parties after the remedy is applied, but on whether the merging entity -or the final purchaser if a divestiture is accomplished- will enjoy more chances to exercise market power, hence creating anticompetitive effects. As previously advanced, while divestitures are generally considered by competition enforcers as a particularly well suited tool –due to the absence of subsequent supervision-, under certain circumstances other alternatives might better address the actual competition concerns that the transaction could raise.

[203] The European Commission sets, in point 48 of its Commission notice on remedies, the basic requirements that a purchaser should meet, i.e. being unconnected to the merging firms, having the ability (in both technical and financial terms) to run the business and not being likely to raise competition concerns.

Amongst these alternative measures, the introduction of behavioral remedies appears to have been recognized[204] as an effective mechanism, particularly if they are combined with structural remedies when the transaction implies vertical or conglomerate aspects. Thus, remedies based on conduct requirements have the advantage of being flexible, easily adapting to different scenarios. Indeed their enforcement may be extended or reduced depending on the evolution of the competition in the market concerned. This flexibility turns out particularly relevant in the electricity sector, as the European Commission has acknowledged on several occasions that the analysis of a merger transaction will have to be developed "*against the background of the state of liberalisation of the electricity markets*".[205] In this respect, the path to the promised land of liberalization remains a dynamic process that, therefore, will benefit from flexible mechanisms in the application of merger remedies.

Behavioral remedies such as the compromise of the companies to abstain from certain conducts have already been considered in mergers connected to the electric industry. In the case related to the creation of a joint venture company (EDFT) for the trading of energy -and particularly electricity- between the French electricity incumbent EDF and SA Louis Dreyfus & Cie[206], the European Commission considered that the competition concerns could be addressed by committing the parties not to engage -through EDFT- in activities related to the sale of electricity to eligible customers in France. [207]

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[204] Commission notice on remedies, point 17.
[205] Case M.1853 - EDF / ENBW (2001), point 13.
Thus, the European Commission decisions in cases such as EDF/ Louis Dreyfus (M.1557 -1999); Grupo Villar Mir/ EnBW/ Hidroelectrica del Cantabrico (M.2434 - 2001); or the above mentioned EnBW/ EDP/ Cajastur / Hidrocantabrico, show the extent to which definition of the relevant product markets (and particularly those related to supply activities) will vary according to the existing degree of liberalization.
[206] Case M.1557 – EDF/Louis Dreyfus (1999).
[207] To that end, there were created "Chinese walls" that would prevent the transfer of sensitive information from EDFT to EDF when it comes to, amongst others, certain conditions incorporated to the contracts with customers.

In this decision the degree of market liberalization was also taken into consideration when defining the appropriate remedy. Indeed, at that time the EU Directive 96/92 on the creation of the electricity common market was not implemented in France and, therefore, entries by newcomers to the electricity supply business were not legally “compelled”. The foregoing flexibility of the behavioral measures was clearly reflected in this decision, insofar as it was established that the commitments not to share certain information would be linked to the implementation in France of the Directive 96/92. Thus, the Chinese walls would be maintained as long as competition in the electricity supply market was not effectively created. In this respect, mergers that do not raise any competition concern in one liberalized country with its markets already opened to effective competition could, on the contrary, be subject to stringent conditions in a Member State in which the liberalization process has not reached an advanced stage.[208]

To a certain extent, the European Commission has in practice recognized this virtue, increasingly[209] bringing into play behavioral remedies where vertical concerns were at stake. In its Merger Remedies Study, the European Commission recognizes that the possibility to modify or rescind the commitment over the time *“meant that such commitments – if shown to be excessive or no longer necessary because of market circumstances – could be altered with fairly minimal disruption to the parties or the marketplace. In fact, interviewed parties consistently pointed out the need for review clauses in commitments involving the grant of access.”*[210] Some of the alleged

[208] Even in one and the same Member State, measures that are needed today in order to foster competition could be no longer required after several years.
[209] According to the European Commission’s “Merger Remedies Study” (2005), “*vertical concerns were mainly addressed by commitments to grant access (83%).17 Access remedies were also accepted to resolve competition concerns in cases involving a combination of horizontal and vertical concerns*.”
See also DAMIEN GERADIN, REMEDIES IN NETWORK INDUSTRIES: EC COMPETITION LAW VS. SECTOR-SPECIFIC REGULATION 56 (Intersentia, 2004).
[210] Merger Remedies Study (2005), page 116.

shortcomings of the behavioral commitments (e.g. the requirement of granting open access to a company’s key assets reduces the incentive of incumbents for investing in certain infrastructures, R&D, etc.)[211], could even be addressed by means of an appropriate enforcement of the remedy (a given behavioral condition could be softened over the time and so the disincentive to invest).

A hybrid[212] solution between structural and behavioral remedy was undertaken by the European Commission when it authorized the acquisition of EnBW (a German market player in the field of electricity supply activities in the Southwest of Germany, close to the French border) by EDF.[213] The clearance was subject to, amongst other conditions, a capacity release commitment aimed at eliminating the competition concerns detected.[214] The capacity release consisted of the obligation for EDF to give access to its electricity generation capacity in France to other competitors, principally by means of Virtual Power Plants for an initial period of five years (up to 5,000 MW comprising 4,000 MW of baseload and 1,000 MW of peakload capacity).[215] Here again,

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[211] Behavioral remedies might consist of the “*granting of access to key infrastructure, networks, key technology, including patents, know-how or other intellectual property rights, and essential inputs*”, Commission notice on remedies, point 62. These remedies seek, for the most part, market entries by new competitors.
The removal of existing exclusive agreements may also be viewed as another way of mitigating potential anticompetitive effects stemming from the transaction. As pointed out by the European Commission in its notice on remedies, in Case COMP/M.2822 — ENI/EnBW/GVS (2002), it was granted an “*early termination rights to all local gas distributors concerning long-term gas supply agreements*”.

[212] Beyond the depiction of the different kind of remedies set in the European Commission’s notice on remedies, it is not always clear what the nature of a measure is, behavioral or structural. In the case M.2684 - EnBW / EDP / Cajastur / Hidrocantabrico, the European Commission met the concerns related to the potential increase of isolation of the Spanish wholesale electricity markets (already highly concentrated), by accepting the undertakings offered by EDF (which jointly controlled EnBW) and EDF-RTE (operator of the French electricity grid) to take “*all the necessary steps in order to increase the commercial capacity on the interconnector which transmits electricity across the Pyrenean chain to about 4,000 MW from an existing 1,100 MW. The capacity increase will take place gradually over a short-/mid-term period.*”As it is asserted later in this section, the difference between these types of remedies might result irrelevant inasmuch as they are capable of removing the competition concerns detected in the transaction.

[213] Case M.1853 - EDF / ENBW (2001)

[214] The transaction, as proposed by the parties, would have led to the strengthening of EDF's dominant position on the market for supply of electricity to large customers in France. Indeed, the merger as originally filed would have removed one of the most likely potential competitors with ability to enter the French retail market.

[215] The use of VPPs as a way of mitigating the exercise of market power by incumbents has been broadly

the flexibility of this mechanism avoid permanent divestments, permitting the European Commission to adapt the length of the measure to the pace in the opening of markets to competition (the initial 5 year-period for the VPPs to run, was subsequently extended, subject to minor amendments, for a further term of 4 years).

However in practice, most of the behavioral measures are accompanied of structural remedies.[216] Thus, regardless of the nature of the remedy finally chosen within the framework of a given merger operation, it will remain essential to ensure that the commitment addresses the anticompetitive effects previously detected by the European Commission. And in this endeavor, a mix of behavioral and structural measures might be the most effective approach.

A more controversial question revolves around the fact of whether the European Commission, when analyzing the appropriate remedies to a proposed merger, should explicitly invoke other than competition-related arguments, such as EU energy policy objectives. Having reviewed throughout this section the different consequences that one or another approach to merger control in the electricity field might bring to the integration and liberalization goals, the following section further examines the rights and wrongs of the incorporation of those others considerations in the European Commission analysis.

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extended also amongst the national competition and regulatory authorities (including, besides the French case, VPPs taken place in Denmark, Germany, Belgium and Spain amongst others). However, criticisms have been raised when it comes to the success of this method on the actual promotion of market entries, etc. Factors such as the definition of strike prices and reserve prices have led to legal battles in Spain between incumbents, bidders and the Ministry of Industry that, eventually, might lead to the removal of this mechanism.

[216] Thus, the VPP "solution" used in the EDF/ EnBW case was complemented with a series of additional measures such as the divestiture by EnBW of its shareholding in the company WATT. Other cases combining behavioral and structural remedies are, for instance, the proposed acquisition of exclusive control of Segebel (company with a 51% stake in SPE, the second largest electricity operator in Belgium) by EDF. In this case the condition consisted of an immediate divestiture combined with an obligation to invest in electricity generation facilities. M.5549 - EDF / Segebel (2009).

5. EU Merger Control in the light of the "Third Energy Package": exploring further involvement in the liberalization process.

So far this paper has reviewed some of the aspects that should be taken into consideration when analyzing transactions in the electricity sector. Indeed, assuming that the role to be played by the EU merger control is increasingly relevant for achieving the integration and liberalization goals (and particularly to address some structural flaws frequently suffered by the electricity markets), previous sections have gauged the ability of different merger control approaches to identify some of the relevant factors that might affect the development of competitive markets. The array of issues ranges from merely jurisdictional questions -such as the application of the Two Thirds Rule- that however might endanger a comprehensive control by the European Commission over all mergers having potential cross-border effects, to the substantive analysis applied when analyzing electricity-related mergers. As it has been constantly reminded, all those elements, if not conveniently assessed, may have consequences for the achievement of the integration and liberalization of the electricity markets.

Against this background, the question of including non-competition concerns (such as energy policy objectives, not necessarily directly related to the transaction being analyzed by the competition agency) arises as the regulatory measures in the electricity sector have not always proven to be as effective as expected.[217] Thus, a major boost for the liberalization process might be given by means of the merger control. By contrast, some incumbents, but also various Member States, have also claimed that "too

[217] This question has been also subject to discussion within the context of the EU antitrust enforcement, particularly when it comes to the use of the remedies provided by article 7 of the Regulation 1/2003 (related to the implementation of the rules on competition laid down in arts 81 and 82 of the EC Treaty [2003] OJ L1/1) in order to achieve, for instance, ownership unbundling not reached by means of regulatory provisions. See Hubertus Von Rosenberg, *Unbundling through the back door...the case of network divestiture as a remedy in the energy sector*, 30(5) 237-254 (E.C.L.R. 2009).

strict" merger control could hinder the establishment of strong European actors which are required to match the power of external suppliers.

In fact, explicitly or implicitly, EU policies related to the security of supply, liberalization and integration of the markets or purely environmental aspects –some of them clearly developed by the third energy package- are at stake when analyzing merger operations in the electricity sector. In this context, it is noteworthy that procedures lay down in different EU Member States as well as at the US federal and state level jurisdictions have included, one way or another, some factors alien to pure competitive considerations in their merger control analysis. Before addressing the appropriateness of including considerations related to these matters in the European Commission's merger control procedure, this paper will briefly analyze those concerns and how other jurisdictions have dealt with them.

a. EU merger control v. other competition-related considerations

First, halfway between purely competition concerns and EU energy policy goals, the liberalization of the electricity markets is a variable that the Directorate General for Competition of the European Commission has already taken into consideration when reviewing mergers in the electricity sector.[218] Initially, this factor was used to better appraise the consequences that a merger operation could entail in a more or less concentrated environment. Likewise, this variable was applied to define a relevant market according to the "relevant state of liberalization".[219] In that sense, the significance of the existing level of liberalization was limited to its instrumentality as a tool serving to better gauge the effects of a transaction in a, for instance, already concentrated market.

[218] Case M.1557 EDF/ Louis Dreyfus (1999)
[219] Case M.1853 - EDF / ENBW Point 13 (2001).

The employ of the liberalization as a goal that should be expressly pursued by means of the merger control has been an issue much more blurred though. As a result of the findings of the European Commission sector inquiry[220], different representatives[221] of this Institution, and the Institution itself through different reports published in the last years[222], have pointed at merger control as one of the potential drivers to remedy some of the woes that slow down the consecution of the liberalization process (amongst others, high levels of market concentration, but also little cross-border integration or vertical integration). However, beyond these institutional statements, the European Commission has not clearly introduced this factor in its Merger Control decision-making procedure.[223]

In this respect, different authors[224] have discussed about the convenience of continuing applying a so-called "principle of neutrality" in the merger control enforcement –that in theory would imply the European Commission "confinement" in competition-related arguments when analyzing concentrations in the electricity sector. While this issue is further considered later in this section, this paper finds reasonable that merger control became an important device to contribute to the EU integration and liberalization process; in this sense, the inflexible and orthodox vision on the enforcement of merger control relying uniquely on competition grounds might need to

[220] Communication from the Commission: Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report) (2007).
[221] Philippe Lowe, former Director General of the Directorate General for Competition of the European Commission, *The Liberalisation of EU Energy Markets*, The Royal Society, London (9 November 2006).
[222] Communication from the Commission: Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors Point41 (Final Report).
[223] While the liberalization process in the electricity and gas markets have been extensively analyzed in the Case M.3440 - ENI / EDP / GDP (2004), others factors drove the final decision of the European Commission.
[224] See François Levêque, *Antitrust Enforcement in the Electricity and Gas Industries: Problems and Solutions for the EU* (CERNA, June 2006); and Francesco María Salerno, *Current Issues of EU merger control in the energy sector: a proposed framework to foster the dialogue* (ECLR, 2007).
In a similar approach to this issue, the letter sent to the European Commission by OFGEM (see note 105) within the context of the Ruhrgas' acquisition by German utility E.ON, the British regulator requested a clear interaction between regulatory and merger control measures, proposing, amongst others, that "*competition authorities could where appropriate permit mergers only where unbundling is promoted*".

be reconsidered because, amongst other reasons, legal arguments for the incorporation of other variables do exist. Additionally, should the measures on unbundling contained in the third energy package do not come into fruition, the EU merger control might contribute to offset regulatory pitfalls by, for instance, addressing transactions that imply further vertical integration between generation and transmission activities.

In the US, it is not uncommon that an authority responsible for the clearance of a merger operation conditions its approval to the fulfillment of some additional requirements, not necessarily related (at least in a straightforward way) to usual competition factors. Indeed, FERC usually required utilities implied in a merger, prior to granting its approval, to join an Independent System Operator or Regional Transmission Organization.[225]

Second, the electricity prices (both at wholesale and retail level) resulting from a merger transaction also become a source of concern for the European Commission –as well as for any other competition authority responsible for merger control enforcement-, and, above all, for the European consumers. European Commission’s findings in this field have revolved around two main areas, namely, the external aspects that might cause price increases –particularly fuels costs and CO2 emission trading scheme- and regulated subsidized tariffs to resident and energy intensive customers.[226]

The analysis of the real effects on prices stemming from merger operations goes beyond the scope of this paper; however, it should be pointed out that, while an appropriate control of merger operations can maintain and develop effective competition that, eventually, might result in more competitive electricity prices on wholesale and retail markets, consumers in many countries of the EU (as it has also

[225] Those conditions are mainly linked to FERC’s efforts of boosting the deregulation process in the electric industry.
[226] DG Competition report on energy sector inquiry (SEC(2006)1724, 10 January 2007), Part II.

been the case in some areas of US)[227] have for a long time benefited from access to electricity at regulated subsidized tariffs. This factor has deprived the final consumers from receiving price signals that, as a result, apart from the fact of limiting the alternatives to discipline the wholesale market prices, has created a false perception of what electricity prices should be. Accordingly, this has created a misconception of what the results of the liberalization might be in terms of electricity prices.

As in some other jurisdictions where liberalization processes have taken place, in some areas of the US rises of electricity prices that occasionally followed the deregulation process have prompted complaints in the consumer side, and a sense of uneasiness in the political front. As a result, different mechanisms have been implemented to protect consumers (particularly, but not exclusively, residential customers) from price volatility. The suitability of these policies being a matter of opinion, it is apparent that at least some of those mechanisms have proven to entail different shortcomings in the long run.[228] Accordingly, the introduction of considerations (and potential conditions) related to prices in the merger analysis tend to be more sensitive in the framework of industries in the process of liberalization and should be carefully approached.

b. EU merger control v. energy related considerations

The security of supply is one of the variables that, being more closely linked to pure energy concerns, arises when a merger operation is proposed in the energy market. Its significance is not a secret neither for consumers and energy incumbents nor for

[227] Countries like Portugal, France, Italy, Spain, Hungary or Poland have maintained for longtime regulated supply tariffs, many times situated below wholesale market prices (provoking clear disrupts in competition when, for instance, the supply at those privileged rates is restrained to a certain type of companies).

[228] Depending on the configuration of the price ceilings, this mechanism might prevent demand from disciplining wholesale prices. Moreover, apart from not favoring conservation and efficiency-related initiatives launched by the European Commission, price caps could also affect competition between suppliers if some of the electricity providers are banned from supplying electricity at those advantageous rates (particularly if such rates are offered at prices well below marginal costs).

public Institutions (both at national and EU level).

On the electricity front, the EU suffered in November 2006 a serious blackout that left more than 15 million European households without power supply and triggered the alarms related to the reliability of the European electricity markets. A subsequent report[229] issued at the request of the European Commission pointed mainly at the lack of security procedures of the TSO origin of the fault (i.e. E.ON Netz), absence of adequate coordination with other TSOs and the insufficient investment both at the reliability level and operation of the grid. In the US, the security of electricity supply also came under the spotlight as a result of the California energy crisis at the beginning of the 2000s, which origin might be found in the lack of investment in new generation and transmission capacity and a probably inadequately designed regulatory framework.[230]

The importance given to this matter has been reflected in the European Union by the approval in 2005 of a European directive specifically devoted to security of electricity supply and infrastructure investment.[231] This Directive aims at establishing measures that preserve *“security of electricity supply so as to ensure the proper functioning of the EU internal market for electricity, an adequate level of interconnection between member states, an adequate level of generation capacity and balance between supply and demand.”*[232] When doing so, the directive requires the Member States to focus on questions like diversity in the electricity generation mix, development of cross-border cooperation and regularly maintenance of transmissions

[229] “Final Report System Disturbance on 4 November 2006” published by the Union for the co-ordination of transmission of electricity. Report available on December 19, 2009 at: http://www.entsoe.eu/fileadmin/user_upload/_library/publications/ce/otherreports/Final-Report-20070130.pdf

[230] Many valuable dissertations have been written about this issue. For instance see, D. Bush, *In (Reluctant) Defense of Enron: Why Bad Regulation Is to Blame For California's Power Woes, or Why Antitrust Law Fails To Protect Against Market Power When the Market Rules Encourage Its Use* (Oregon Law Review, Vol. 83, p. 204, 2004).

[231] Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment.

[232] Id.

and distribution networks. Likewise, security of supply has also been at the center of the third energy package, standing out as one of the main objectives of the directive 2009/72. As already discussed, this directive included a provision related to the acquisition of Transmission System Operators (TSOs) by operators from a third country company, foreseeing the possibility that the national regulatory authorities[233], upon approval from the European Commission, refuse the certification required for a TSO to operate, should the controlling company "*put at risk the security of energy supply of the Member State and the Community*".[234] In that sense, in order to evaluate the jeopardy of the security of supply, practically any circumstances of the case as well as of the third country concerned can be analyzed.

Notwithstanding this, the security of supply has not become a conclusive factor neither to determine the clearance or challenge of a merger operation, nor to settle on potential remedies to a transaction at the EU level. However, what the EU merger control Regulation 139/2004 do foresee in its article 21.4 is the possibility that the Member States "take appropriate measures" to protect interests that have not been considered by the European Commission when analyzing the operation:

> "*member states may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation* [139/2004] *and compatible with the general principles and other provisions of Community law. <u>Public security</u>, plurality of the media and prudential rules shall be regarded as legitimate interests within the meaning of the first subparagraph. Any other public interest must be communicated to the Commission by the Member State concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken. The Commission shall inform the Member State concerned of its decision within 25 working days of that communication".*[235] (Emphasis added).

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[233] Independent bodies that, pursuant to recital 36 of the Directive 2009/79 "*should be able to fix or approve tariffs, or the methodologies underlying the calculation of the tariffs, on the basis of a proposal by the transmission system operator or distribution system operator(s), or on the basis of a proposal agreed between those operator(s) and the users of the network. In carrying out those tasks, national regulatory authorities should ensure that transmission and distribution tariffs are non-discriminatory and cost-reflective, and should take account of the long-term, marginal, avoided network costs from distributed generation and demand-side management measures."*

[234] *Id.* at art.11

[235] Regulation 139/2004, art. 21.4.

In spite of the at first view “alarming” blurring of the one-stop-shop principle supported at the EU level, this provision does not, in general terms, frustrate the applicable exclusive jurisdiction of the European Commission over concentrations with Community dimension. Indeed, the attribution included in this provision does not enable a Member State to approve a transaction prohibited by the European Commission, but just to bar, subject to stringent requirements, a merger cleared by the European Commission.[236]

Member states have in turn reacted to the security of supply concern by trying to foster national energy champions by means of mergers being reviewed at a national level (in certain occasions as a result of the Two Thirds Rule). As briefly exposed in previous sections, this tendency has been counteracted (or at least mitigated) by the European Commission in so far as it frequently implies infringements of competition rules, sector-specific regulations (or both). But apart from the breach of the EU legislation that those conducts might entail, the effectiveness itself of those national champions over the goals that their corresponding governments purport to achieve is, at least, doubtful. In fact, individual initiatives tending to create national champions have probably few chances to unilaterally resolve the security of supply concerns that a country might face.

Finally, the main market operators have also had a say in this discussion about security of supply. While a proper liberalization of the electricity and gas markets appears to have gained acceptance as a way to create efficiency gains[237], some concerns remain unsettled. It has been frequently argued by some incumbents that a strict application of the merger control could hinder EU’s objective related to the security of

[236] EDURNE NAVARRO ET AL., MERGER CONTROL IN THE EU 412 (Oxford ed., 2d ed. 2005).
[237] See for instance outcomes of the second Transatlantic Energy Security Dialogue on “Security of Supply in Liberalized Energy Markets Transatlantic Experiences and Future Challenges” organized by The Global Public Policy Institute (GPPi) (Berlin, 25 May 2007).

supply since only large utilities can afford the investments required in order to maintain and develop the required level of networks and cross-border interconnections; in some cases it has been even feared that “*private energy markets may not be able to effectively address a range of issues related to security of supply*”.[238]

Lessons learned from the above mentioned energy crisis have however showed that the security of supply, commonly defined as reliable energy provided at reasonable cost, greatly depends at the EU level, at least on the electricity front, on variables like cross-border interconnection (being also this factor a requirement to achieve full market integration), diversification of the portfolio of technologies used to generate that electricity[239], appropriate congestion management and sound electricity markets. Closely related to these elements it also outstands the separation of network operation and grid development from generation and supply activities.[240] For similar reasons, the vertical integration in electricity markets, while being susceptible of providing energy efficiencies, might have negative effects on the security of supply given the shortage of liquidity that vertical integration can involve.

Thus, while loosening up merger control standards does not appear to be an effective answer to address concerns in this field, it is clear that security of supply (and particularly related elements such as fostering of interconnection) can be affected by major mergers. The question that arises is to what extent EU merger control enforcement should grasp strategic advantages of cross border mergers and include this consideration into its analysis. Some progress in this sense has been already detected when the European Commission has made its approval of a merger conditional to the

[238] Id.
[239] SECURITY OF SUPPLY IN ELECTRICITY MARKETS: EVIDENCE AND POLICY ISSUES (OECD, 2002).
[240] Indeed, incumbents, under certain circumstances, might not be motivated to invest in transmission should the resulting enhanced capacity brings more competition to the markets where they deploy their activities.

development of interconnection facilities between two Member States.[241] However, for the time being, these decisions are probably more linked to competition goals rather than objectives connected to the security of supply.

Ultimately, environmental aspects like the consecution of cleaner energy sources set in the third energy package can also be seen by some observers as a variable to be taken into consideration in merger operations (e.g. environmental objectives might be reached by favoring, for instance, remedies tending to require to the electricity companies the development of less polluting power plants; in that sense, reduction of emissions might be also taken into consideration when analyzing possible remedies).

In conclusion, it is clear that the amount of issues that can be taken into consideration in the framework of merger transactions is broad. However, drawing the line between the reasonable elements that a competition authority could incorporate to its analysis and the excessive discretionary power that would be granted to the European Commission as a result of the inclusion of multiple items of evidence upon which take a merger decision (that, at the end, might endanger the legal certainty and necessary predictability when proposing merger operations) is not obvious. Concepts like public security may help to resolve this dilemma. The elaboration of mandatory but not binding reports on these non-competition aspects by other divisions within the European Commission (but not the Directorate General for Competition itself) could also be part of a solution, avoiding the adulteration of the competition analysis carried out by that DG Competition (at the same time that accommodates some of the concerns expressed by different Member States, but from a communitarian perspective).

c. A well-balanced merger control enforcement

[241] See the commitments undertaken by EDF/RTE related to the measures necessary to increase the commercial interconnection capacity between France and Spain. Case M.2434 - Grupo Villar Mir / ENBW / Hidroelectrica del Cantabrico (2001).

The debate about the convenience of having the European Commission addressing non-competition goals in its decisions over merger operations should take into consideration the current existence of provisions in the EU Merger Regulation that already incorporates into the analysis elements alien to competition. In fact, the article 21.4 of Regulation 139/2004 mentioned before is clear evidence that, under certain circumstances, there is room for considerations not directly linked to competition law analysis. Thus, EU energy principles like the security of supply could be given a room in the merger analysis undertaken by the European Commission without being at odds with the philosophy of the EU merger enforcement. Progress on the development of transmission and cross-border infrastructure, higher levels of cooperation between TSOs or diversification of the mix of generation could become objectives to be expressly pursued by the remedies insomuch as they contribute to ensure the maintenance of electricity supply at reasonable prices.

The incorporation of this dimension to the analysis of mergers applied by the European Commission would be particularly favorable in so far as it could in a way replace (or render unnecessary) measures to guarantee security of supply undertaken unilaterally by Member States. In fact, the concern about ensuring electricity supply would remain intact, but its application could pass, at least when it comes to the merger operations with cross-border effects, to a centralized body that can reasonably have a broader view, more consistent and effective in the long term.

Furthermore, finding legal systems that expressly accommodate possible security of supply objectives to the final decisions to be undertaken within the framework of a merger is not unusual. For instance, the UK legislation[242] on merger control grants the national competition authorities the prerogative of challenging an operation that might

[242] UK Enterprise Act (2002), chapter 2.

endanger "*interests of national security*". When it comes to the US, the objective of FERC when analyzing a merger consists of ensuring that the transaction is consistent with the public interest (that, as explained in previous sections, include –at least in theory- the analysis of the merger's effect on competition, on rates and on regulation).[243] In practice, however, the consideration of some factors foreign to competition objectives appears to be much more atypical.[244]

Additionally, as some observers have pointed out[245], the EU Merger Regulation does not only pursues the maintenance of effective competition in the common market, but also its development, showing a clear vocation towards variables that contribute to achieve that level of effective competition. Therefore, that factor would further allow reviewing mergers under the liberalization prism, given the alleged consequences for competition that such process of liberalization could bring in the long run.

Finally, the proposed intertwining of non-competition goals within the merger control enforcement should not be deemed inconsistent with the criticism occasionally made to some Member States as a result of their consideration of other than competition-related matters. In fact, the significance of principles like the security of supply is rarely disputed; on the contrary, the reproach to some Member States frequently stems from the biased, and in some occasions dogmatic, application of that principle in order to favor national companies, usually missing the actual challenging points that the transaction may generate.

[243] See the proposed merger between American Electric Power Company and Central and Southwest Corporation (2000), subject to the FERC supervision.
[244] For instance, when it comes to the potential incorporation of the effect of a merger on the environment as a factor in deciding about the approval of the transaction, FERC has "*recognized that a particular merger can have environmental effects*"; however they "*do not see the need to change our regulation, which explicitly addresses the possibility that an EA or EIS may, on rare occasions, be needed*". Merger policy statement, 1996.
[245] See François Levêque, *Antitrust Enforcement in the Electricity and Gas Industries: Problems and Solutions for the EU*, (CERNA, June 2006).

6. Conclusions

This paper has analyzed the factors that the EU and US merger control enforcement consider in the process of reviewing transactions in the electricity sector. Particularly, the challenges and potential consequences for the integration and liberalization processes that may stem from one or another manner of implementing the merger control have been highlighted. On the EU front, the paper analyzed procedures that might put in jeopardy the European Commission’s effective supervision over all mergers having potential cross-border effects.

Specifically regarding the application of the Two Thirds Rule, this paper included a plea for the European Commission jurisdiction over mergers in the electricity sector if the effects of a transaction spill over the boundaries of one EU Member State. Compromise solutions that would not offensively invade the field of competence of national competition authorities could be undertaken, limiting the additional power granted to the European Commission.

As for the substantive analysis applied when analyzing electricity-related mergers, it has been noted that the analysis of the mergers should not end with the calculation of the market concentration, being necessary to give, on the contrary, more credit to the examination of the real competition effects derived from the transaction. In this respect, the approach undertaken by DOJ, and in general terms the analysis that the European Commission has followed when analyzing mergers in the electricity field, has proven to be more successful detecting competition concerns than the speedy analytical screen applied by FERC. Vertical and conglomerate mergers in electricity markets have also drawn particular attention and require the appropriate care of the European Commission.

This “mantra” should be followed as well when analyzing potential remedies, focusing on measures that tend to eliminate the competition concerns. Behavioral remedies could help (and in practice do help) to reach that goal in the electricity sector (depending on the circumstances, in combination with structural remedies or not). Therefore, the European Commission’s notice on remedies might go wrong when underestimating the value of those measures.

As a result, while the approach and the test applied to analyze mergers in the electricity sector does not need to be structurally different to the one undertaken when reviewing concentrations in other industries, their interpretation must be flexible enough to accommodate the idiosyncrasies of the electric markets.

Finally, when it comes to the incorporation of EU policies related to the security of supply, liberalization and integration of the markets or purely environmental aspects to the analysis of a merger undertaken by the European Commission, the paper has noted the possibility for that inclusion insomuch as it falls under principles related to public security or merely if they favor the development of competition within the common market.

In sum, this paper supports that merger control, side by side with the new regulatory framework approved in the electricity sector, could become the suitable “missing link” required in order to avoid additional future energy packages. Particularly, should the measures contained in the recently approved energy legislation not come into fruition, the EU merger control might contribute to offset those regulatory pitfalls.