Energy Power Risk Management

SPANISH POWER

Takeover battle tests competition

Although the Spanish power market is open to competition, it is still dominated by two companies, and it continues to be difficult for others to gain a significant market share

BY CAITLIN RANDALL

Getting into Spain's electricity sector is a bit like jumping into a bullring. All you need is raw nerve and the strength to pick yourself up when it's all over. That is how one analyst sums up the scene for foreign companies trying to enter the country's recently liberalised power market.

Indeed, May's failed take-over bid by the Dallas, Texas-based energy major TXU for the smallest of Spain's four power companies, Hidroelectrica del Cantabrico, neatly illustrates the point. And, in the view of some analysts, it also offers up a key test of just how willing the country's centre-right government is to fully open the domestic power market.

TXU abandoned its bid for Cantabrico when Union Electrica Fenosa, a rival Spanish generator, countered with a higher offer. Virginia Sanz de Madrid, a senior analyst with Deutsche Bank in Spain, says: "There still remains the unanswered question of whether Union Fenosa's bid was voluntary or, as some people speculate, was pushed forward by the government in an effort to keep TXU out. With two companies now controlling a very high proportion of the market, it has become very difficult for an outsider to break into the sector," she adds.

Endesa and Iberdrola, the two dominant electricity suppliers, control more than 70% of the market, but the acquisition of Cantabrico would allow Union Fenosa to compete as a third player, lifting its share of the domestic power market from just over 13% to nearly 20%, analysts say (see figure).

But with the way apparently cleared for Fenosa, the Spanish government took a surprise tack. As *EPRM* went to press, it said it would block Union Fenosa's takeover bid. Rodrigo Rato, Spain's deputy prime minister, said in late May that any decrease in the number of suppliers would reduce competition in the electricity market. Spanish press reports quoted unnamed advisers close to Cantabrico as accusing the government of playing into the hands of Endesa and Iberdrola.

Victor Peiro, the head of research at Caja Madrid Bolsa, a Spanish brokerage, says: "There was always a lot of objection from [the public] to allowing Fenosa and Cantabrico to merge, reducing the competitive field to three players. But now, by blocking the bid, the government has given the impression it is interventionist," he adds, noting that now the bidding process appears to have started from scratch with foreign contenders back in the running, including TXU, which is expected to re-table its offer. It is still unclear how the government will view new foreign bids. As *EPRM* went to press, a TXU spokeswoman says the company was considering its position.

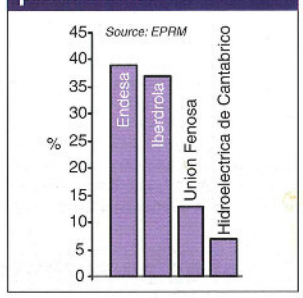
One industry analyst, based in Madrid, says: "The government appears to have changed its mind midstream. First, it most likely encouraged Fenosa, which wouldn't have made a bid without at least tacit government support. And then, suddenly recognising how blatantly anti-competitive they appeared, withdrew support, " he says.

Sanz de Madrid with Deutsche Bank adds: "Logically, the government should force Endesa to reduce its market share. But this government favours 'national champions' – companies such as Telefonica, Repsol and Endesa, which diversify and fly the flag," she says.

TXU kicked off the bidding war for Cantabrico in March with an offer of €2.28 billion ($2.12 billion). The Texas company, with assets of more than $40 billion, says the bid for Cantabrico was its biggest move in Europe since buying the UK power supplier Eastern Group in 1998. It acquired 5% of Cantabrico at that time, and has since increased its shareholding to 14%, making it the power group's largest shareholder.

The take-over battle dragged on when TXU refused to support a motion to change Cantabrico's bylaws, limiting voting rights to a maximum 10%. This was a key prerequisite for Fenosa's bid to proceed. Fenosa had made its bid for Cantabrico conditional on obtaining 80% acceptance, unless the shareholders approved the bylaw change – in which case they would reduce the acceptance threshold to 51%.

Main players in Spain's power market



Other companies were invited to present counteroffers, but Germany's Energie Baden-Wurttemberg (EnBW) withdrew its planned bid after learning the Spanish government objected to the fact that the state-owned Electricité de France owned a 25% stake in EnBW. Under Spanish law, foreign state-controlled companies are barred from taking over Spanish electricity utilities. EnBW's withdrawal left the field clear for Union Fenosa.

But some industry observers argue that by refusing to allow state-participated foreign companies to enter liberalised sectors such as electricity and telecommunications, the government threatens to limit the growth of Spanish companies at a time when the rest of Europe is scrambling to consolidate.

In May, TXU decided to support the bylaw change to avoid a "stalemate" within Cantabrico's board. At an earlier shareholders meeting, Hidrocantabrico chairman Oscar Fanjul accused TXU of obstructionist tactics when it abstained from a critical vote to limit voting rights to 10%.

Analysts say the eventual outcome of the takeover battle will test the Spanish government's commitment to opening the market. ■