

## **Electricity: the Shifting Power Equation**

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Two years of twists and turns have finally ended up – provisionally – with the announcement of a deal between the German energy company E.ON, the Italian group Enel and the Spanish BTP group Acciona to slice up Endesa, the top Spanish electricity firm. Most analysts focused on the gains and losses of each player. E.ON drops most of its prey but gains three bridgeheads in Spain, Italy and France. Enel pays a high price but gains critical mass in nuclear and coal-fired power stations. The Spanish government, after repelling the German invader, partly saves face with a more ‘Latin’ Enel/Acciona tandem while failing signally to create a national energy champion. The issue has also brought to light some long-standing Spanish quirks: the politicisation of business, with an ubiquitous role of regional savings banks closely linked to political parties; an out-of-date securities environment, with a regulatory authority whose credibility is in tatters; regulatory and legislative instability, with a government which overruled its own competition authority before hastily amending the electricity law in an apparent reaction to the attack of E.ON.

But perhaps the most interesting aspect lies elsewhere. Shareholder pressure and European competition rules are inexorably combining to shift the electricity sector towards new market structures. Of the three scenarios envisaged for Endesa (a merger with Gas Natural, a purchase by E.ON, or a break-up), the third is by far the most in tune with the vision promoted by Brussels: less concentrated national markets gradually opening to form a single European competitive playground. In Spain, Endesa was dominant in baseload electricity production, but now there will be three or even four competing suppliers. E.ON and Enel are shaping up as two major cross-border players. In Italy and France, E.ON taking over third place from Endesa will probably not have any immediate consequences. But for the first time in Europe – setting aside privatisations – a dominant national operator will have been dismantled, and the corresponding margin for unilateral influencing of prices will have been reduced. Similarly, in its merger plans with GDF, Suez had to relinquish control over a part of its activities in Belgium, the very market where it was dominant.

Consolidation in the electricity market is set to end up in a redistribution of the cards which can reduce the market power of the biggest. Probably EDF, the French electricity giant, is bound to go the same way. EDF was listed with a vertically integrated structure and a totally dominant position. It will certainly continue to grow outside France – and it is a fair bet that, at that point, it will need to concede a little more room to others within the French market. This may lead it to reduce its vertical integration, by relaxing links between production, transport and distribution, or its horizontal integration, by accepting a smaller share of the production market.

The slow but steady trend towards new market patterns brings out the essential issues for national constituencies and their governments: transport and distribution networks, which constitute natural monopolies; market regulation, to avoid excessive capture of rents by private interests and to guarantee sufficient investment; and supervision of power stations (especially nuclear) to ensure safety and proper management of waste. Therein lie the real public issues. By contrast, power generation facilities are pitted more and more in competition with each other and the identity of their owners is becoming less and less critical. Competition is in no sense incompatible with network security and long-term investment, as long as incentives are correctly designed – a task which is difficult but not impossible, as evidenced by foreign experience such as the PJM Interconnection in the US.

If the regulator does his job properly, the efficiency gains which flow from these reorganisations will land up in the pockets of end-users, as one hopes will be the case in Spain. Little by little, the boxing weight of ex-monopolists with dominant market power and electricity consumers could swing round – in favour of the latter.

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