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# *Eon turnaround upsets Germany's 'third way'*

German energy giant Eon announced in a highly surprising move that it is willing to sell off its electricity grid and 4,800MW worth of power plants. The decision has shocked the industry, angered the German government and ends a years-long face-off between Eon and the European Commission. Observers laud the deal as very smart.

| by Stefan Nicola

On February 28 2008, Germany's Eon dropped a bomb: The Düsseldorf-based energy giant announced it would sell off its 10,000 kilometre high-voltage grid. Moreover, Eon said it would sell (or swap) one sixth, or 4,800MW, of its German energy generation assets – that's the equivalent of five large nuclear power stations. The news came as a surprise to the German government and Eon's competitors as it represents nothing less than a complete turnaround from what Germany's largest utility has preached in the past.

Eon has been among the most outspoken opponents of ownership unbundling (OU), the European Commission's first strategic measure to increase competition (and ultimately drive down prices) on the European energy market. Besides pushing for OU, Neelie Kroes, the Commission's top competition official, has launched cartel proceedings against several big European utilities, and threatened them with hefty fines if they continued to impede competition.

Eon's obvious behind-the-scenes deal with the Commission (which will now close the cartel proceedings) has some experts irritated. 'The charges against Eon were based on potential violations of cartel legislation and it doesn't look too good if you can simply buy them off, especially as the improvement in competition coming from selling off the network may be minor,' says Gert Brunekreeft, Professor of Energy Economics and head of the Bremer Energie Institute, an energy think tank at the Jacobs

University in Bremen. 'The sale of generation capacity, on the other hand, is very substantial – that is where the competitive gain is, so I guess the overall package is fine.' Its ethical ambiguities notwithstanding, the deal hands Kroes a first major victory and the German government an embarrassing slap in the face.

### Exposed |

Because of the industry's pleas, Berlin had lobbied against OU in Brussels and in favour of a 'third way', whereby the grids would be owned by the utilities but organised by an independent system operator. Germany's diplomats had recently scored some victories when they got six other countries on board. Eon's unexpected deal with

the Commission has exposed the German government and Eon's competitors, according to Claudia Kemfert, energy analyst at the German Institute for Economic Research (DIW). 'The German government's third way will now be more difficult to push through,' she says. 'ENBW, RWE and Vattenfall are under increasing pressure to sell their networks as well.'

Eon's German competitors RWE and ENBW have continued to refuse to give up control of their networks. Only Sweden-based Vattenfall has since announced it was 'checking all options' when it comes to grid ownership. Observers say a decision depends on how strong the Commission's competition case is against them. Energy officials across Europe have

joined in criticising Eon's deal.

While it angered Berlin and forces its competitors to make a decision, Eon's move is one that gives the upper hand back to the utility after being on the defensive for years, experts say. 'Considering the position Eon found itself in, it was a very smart move,' says Dieter Helm, an energy expert at Oxford University. 'By selling its electricity assets, Eon will get a large chunk of cash, it closes off the competition inquiries, and it saves Eon a rather hefty fine.' Over the past months, Kroes had left no doubt that she was indeed serious. In late February, Microsoft had to pay \$899 million for defying a landmark 2004 anti-trust ruling. A few weeks earlier,

### Dispute

The dispute between Eon and DG Competition dates back to February 2006, when DG Competition released its preliminary report on its energy sector inquiry. The data gathered clearly pointed to several competition problems in electricity markets, in particular 'high levels of concentration and a lack of confidence in the prevailing price formation mechanisms'. DG Competition decided to commission an in-depth study to determine whether there is a systematic difference (mark-up) between price levels recorded on electricity wholesale markets and what they would have been had the markets been fully competitive. The results of the study, published on 20 April 2007, showed that some operators 'seem to have not made full use of their generation capacity'. This was one of the allegations made in 2006 by some users in the German market and was one of the areas focused on during the surprise inspections carried out at the premises of German generators, including Eon, on 12 December 2006.

Based on information gathered during a previous inspection on 16 May 2006, the European Commission decided on 30 July 2007 to open formal anti-trust proceedings against Eon and Gaz de France for a suspected agreement or concerted practice between both utilities whereby they agreed not to sell gas in each other's home market. The investigation targeted supplies of natural gas transported over the jointly owned MEGAL pipeline, which transports gas across Southern Germany between the German-Czech and German-Austrian borders on the one side and the French-German border on the other.

Then the Commission said on 30 January 2008 that it had fined Eon 38,000,000 for the breach of a Commission seal on Eon's premises during the inspection in May 2006. *Hughes Belin*



Photo: Juan M. Espinosa/EPA  
Wulf Bernotat, ceo Eon



Photo: Michel de Groot/Hollandse Hoogte

*'By giving in to the Commission they have protected their gas assets'*

Eon was fined €38 million for allegedly breaking a seal after the Commission had raided the utilities' offices, so Eon knew that it would be very costly if the raids indeed unearthed something suspicious.

'I am far from saying that this was a genius coup,' Eon's chief executive Wulf Bernotat recently told German news magazine Der Spiegel. 'Under the current circumstances, however, this is the best that we have been able to achieve.'

### Protection |

And the deal may save Eon some more money. Observers say the utility would have had to spend at least €2 billion to modernise the grid and now it can spend the money on other assets. While diverting some of its German power plants to foreign competitors may hurt Eon's domestic revenues, it may increase the utility's standing in Europe as Eon is likely to pursue asset swap deals with competitors in other countries. So in return for a German nuclear plant, for example, Eon may get

generation capacity in Spain or Italy. Greater competition all over Europe may benefit Eon in the long run. In previous years, the utility focused on internationalisation and is thus well suited to benefit from liberalised markets.

Kempfert and Helm both agree that the biggest positive for Eon is that, by giving in to the Commission when it comes

to electricity grids, they have protected their gas assets.

'Eon knows that the gas market will also see an unbundling debate, and Eon definitely has a dominant position there,' Kempfert says. 'So Eon is trying to take wind out of the Commission's sails in a possible row over a liberalisation of the gas market.'

Helm says Eon's move aims to

protect its prime gas asset, Eon Ruhrgas, which is linked to Gazprom, Russian gas supplies and their associated long-term take-or-pay contracts.

'I wouldn't even call this deal a major victory for the Commission,' he says. 'To be forced to divert Ruhrgas would be an entirely different threat to Eon than selling some of its electricity grid assets.' ■

### Eon grid might be nationalised

Ever since Eon announced it would sell its power grid, speculation about the buyer has been rife. The biggest player that comes to mind is state-controlled Russian energy giant Gazprom. It most likely won't be interested, however: Gazprom has repeatedly stated that the German grid was suffering from too much regulation. German magazine Wirtschaftswoche reported that Spanish construction company ACS and Acciona SA are interested in the grid but ACS has since denied the claim. The Financial Times put National Grid, which distributes electricity and heating gas in the UK, into the bidding game. As an electricity grid guarantees limited but long-term risk-free revenues that become unpredictable in times of volatile financial markets, the most likely buyers could be banks or investment funds. Media reports have since named Australia's Macquarie Bank and Reef Infrastructure, a Deutsche Bank daughter company, as being interested. Yet in the end, maybe there won't be a private buyer after all as the German government is eager to prevent control of the domestic grids from falling into foreign hands. So far, it has brushed aside speculation that it could buy the network. However, a growing number of voices call for state ownership of Eon's network to secure regular investments in the ailing grids and thus boost energy security.