

East German gas company VNG Verbundnetz Gas has managed to remain independent since the transition to a market economy in 1990. With major shareholder EWE, based in northwestern Germany, now trying to take control, the board and other shareholders are fighting back.

VNG's fight for independence

| by Stefan Schroeter

On December 17 2008, the future of Germany's third largest gas supplier was in the hands of the Halle City Council. Councillors had to decide whether Halle should continue to administer its 3.66% share in Leipzig based VNG jointly with 10 other cities in eastern Germany, or whether to take the path advocated by Mayor Dagmar Szabados. She wants to release the stake in VNG from joint administration by the cities and keep all options open, including that of a lucrative sale to major shareholder EWE, an electricity and gas supplier based in Oldenburg, Lower Saxony, in north-western Germany. According to rumours reported in local newspapers, EWE would be prepared to pay more than 50 million euros for the Halle share. In September, at Szabados' initiative, Halle had already terminated the trust deed with VNG's Administration and Holding company, VuB (Verwaltungs- und Beteiligungsgesellschaft). Under that contract, 12 (now 11) east German cities

had pooled their shares, gaining a blocking minority of 25.8% in the largest gas company of their region and guaranteeing them the right to participate in strategic decisions.

For EWE, obtaining Halle's VNG shareholding would be enough to give it control of the company. EWE already holds 47.9% of VNG shares, but it is facing strong resistance to its takeover bid from VNG management and the remaining shareholders: Wintershall, Gaz de France and Gazprom. Behind the scenes, state prime ministers in eastern Germany and federal politicians are working hard to keep the company independent.

Since the transition to a market economy began in 1990, VNG has been one of only a few major companies in eastern Germany to remain independent, by using a minority shareholder model, although Germany's largest gas supplier, Ruhrgas, did have the

most influence with a 37% shareholding. Nevertheless, other shareholders with very different interests, such as Wintershall, VuB, BEB, Eon, Gazprom, Gaz de France and Statoil, provided a balance of power during the 1990s, giving the board a certain amount of elbow room. With turnover of 4.2 billion euros in 2007, VNG is one of the biggest companies in eastern Germany. It is the tenth largest importer of natural gas in Europe. Almost half the gas comes from Russia and 27% from Norway. VNG is currently developing its own gas production facilities in Norway and is becoming increasingly successful as a gas trader in other European countries.

Strategic buyer |

A look back to 2002 is required to understand the many reasons behind the conflict between VNG's shareholders. At that time, the Federal Ministry of Economics and Technology (BMWi), headed



The Norwegian Sleipner Platform from which VNG imports gas. Photo: VNG

by Werner Müller, a Social Democrat, used the seldom-applied instrument of a ministerial authorisation to overrule a decision by the Federal Cartel Office, thus allowing Germany's largest energy company, Eon, to take over the country's largest gas supplier, Ruhrgas. One of the many conditions imposed was that Ruhrgas and Eon would release their VNG shares and sell them to a "strategic buyer". This strategic buyer was to be a robust company in the energy industry 'which has the financial resources and experience needed to safeguard and build on VNG's position as an active competitor at grid gas level.' Other provisions stated that the east German local authorities could purchase a further 10% of the VNG shares. Until that point, they had held 15.8%.

Eon proposed EWE as the strategic buyer. The BMWi examined EWE's overall business plan, which included a structure involving

EWE and VNG as affiliated companies. A consortium contract with VuB was supposed to ensure a majority with voting rights and management of the business by EWE. The plan also set out how the EWE/VNG alliance should be established as the "fifth power" in the energy supply industry - to compete with the four main German energy companies Eon, RWE, EnBW and Vattenfall Europe. According to VNG Chief Executive Klaus-Ewald Holst, at this time the idea of a joint holding company based in eastern Germany was suggested to the prime ministers of states in eastern Germany, but the BMWi says such a proposal was not included in the EWE plan. The ministry finally permitted EWE to purchase VNG shares in December 2003, with no conditions attached.

EWE was then in a position to acquire 47.9% of VNG shares from Eon, BEB and Statoil. The VuB utilities increased their

shareholding in VNG by a further 10% to a total of 25.8%. EWE facilitated this sale by providing a subsidy of 100 million euros, which covered around half the purchase price on behalf of the utility company. In return, VuB concluded a 20-year consortium agreement with EWE, granting EWE the right to manage VNG and guaranteeing it a limited right of pre-emption on municipal VNG shares from 2009. This right would take effect if Halle were to withdraw from the VuB and offer its VNG shares for sale.

Annoyed |

Cooperation between EWE and VNG appeared to be taking off in May 2004, when both boards signed a letter of intent regarding the formation of the joint holding company mentioned by Holst. This model was not implemented, however, even though EWE's decision-making bodies investigated it thoroughly. 'In May

2005, the supervisory board was given the final information,' says Chairman Günther Boeckhoff. 'The shareholders then discussed the matter in depth, and this led to a unanimous rejection of the model.' According to Boeckhoff, tax reasons were the determining factor in the rejection of the holding company, but he declines to say when the supervisory board made the decision.

The local authority VNG shareholders were also annoyed about the fact that EWE was unilaterally angling for partial privatisation of VNG. The public first heard about the ongoing squabbles in May 2007, when the two boards dissolved their temporary integration. The local authorities and other shareholders voted EWE Chief Executive Werner Brinker out of the VNG board chairman's position. VNG

municipal shareholders also cancelled their consortium contract with EWE in September 2008. 'We do not want to stand aside and simply watch as a party to a consortium contract abuses the partnership by buying out one partner after another,' explained VuB's managing director, Andreas Reinhardt. EWE then lodged an arbitration suit against the VuB with a claim for damages of 300 million euros, which SWJ has since joined. Reinhardt expects a decision in the arbitration proceedings in March or April 2009.

Injection |

There is, however, another dimension to the story of the EWE-VNG conflict. The ministerial authorisation of 2002 also required Eon to sell a 27.4% stake of EWE. In 2003, the other EWE shareholders – 21

wind turbines will be built. Over the last two years, EWE has also built up holdings of 80% in each of the regional power suppliers Bursagaz and Kayseri Dogalgaz in Turkey.

Whether everything will work out for EWE with its shareholder EnBW and its injection of capital remains to be seen. The Federal Cartel Office raised objections to the share purchase based on competition law in December 2008 and extended the deadline for examination to March 2009. As justification, it cited the gas markets in eastern Germany, where it was expecting a strengthening of the market domination of VNG and two EnBW subsidiaries in Saxony.

The BMWi, which set the scene for the VNG conflict with its ministerial authorisation in 2002, is now headed by Michael Glos of the Christian Social Union (CSU). In response to a question in September 2008 in the Bundestag from the "Left" parliamentary group ("Die Linke"), his undersecretary, Hartmut Schauerte, expressed a strong interest in retaining VNG as a strong company firmly rooted in eastern Germany. At the same time, he made it clear that, in his view, all the conditions imposed by the ministerial authorisation had been fulfilled. The BMWi could not exert any legal influence on the VNG's shareholder structure. All the same, during a visit to Leipzig in December, Schauerte hinted that the ministry would not leave the future of the VNG to chance. VNG was celebrating the 15th anniversary of the first import contract for natural gas from Norway with its Norwegian partner StatoilHydro. 'I've been working on this matter for some time,' Schauerte said at the celebrations, 'and I hope that we can sketch out a solution in the first few months of the new year.'

Halle City Council's decision the next day was somewhat clearer. It voted with an overwhelming majority to have the VuB continue to administer the VNG shares until 2013. Mayor Szabados has announced her intention to lodge an objection against the vote. ■

Behind the scenes, state prime ministers and politicians are working hard to keep the company independent

also stopped providing EWE with financial information, so EWE lost half of its turnover and a great deal of creditworthiness.

EWE tried other ways to gain a majority in VNG, heralding the start of an extended legal wrangling. In spring 2008 it was revealed that EWE had concluded a contract for sale with the public utility company of Jena (Stadtwerke Jena-Pößneck or SWJ) for its VNG holding of 1.04%. The Jena managers did not agree with Brinker being voted out of office and wanted to use EWE's attractive offer to withdraw from the VuB. However, in the opinion of the other municipal shareholders, EWE and Jena were breaking the consortium contract of 2003. They took the matter to court, won in the court of first instance in November 2008 and were thus able to ward off the loss of their blocking minority for the time being.

When it became clear that Halle might withdraw as well, the east German

boroughs and urban districts – bought this stake for approximately 500 million euros, becoming the full owners of their regional power supplier. Even then, it was their stated intention to sell this stake to a partner in the energy market in the medium term. This partner was found in July 2008, in EnBW, Germany's third largest energy group, which was prepared to hand over two billion euros for a 26% in EWE – a high price. As Brinker explained at the time, the local authorities would get back what they had contributed and the remaining money would be used to strengthen the company.

This is certainly needed. Alongside refinancing the purchase price for the VNG shares, EWE needs the capital for a raft of ambitious projects. It is the largest shareholder in Alpha Ventus, Germany's first offshore wind park, which will probably cost around 250 million euros. It also has shares in the Riffgat offshore wind park in the North Sea, where up to 44