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**Competition at National and International Levels: Energy**

**By**

**Portugal**

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

# **The activities of the Portuguese Competition Authority in the Energy Sector and its role in the liberalization process**

## **I. Introduction**

The Portuguese Competition Authority (PCA) was created in 2003, shortly before a new legal framework for competition enforcement entered into force in Portugal (Law No. 18/2003, of 11 June)<sup>1</sup>.

The PCA has been entrusted with horizontal powers over all sectors of the economy, including antitrust enforcement and merger control. Furthermore the PCA exerts decisive policy influence over legislative measures that may have impact on the market, through Recommendations to the Government and other types of opinions, as well as often carries out extensive market surveillance and sector inquiries.

Since the very beginning of its activities, either *ex officio* or due to merger control procedures, the PCA has granted substantial attention and resources to energy related competition issues. The increase of competition in the energy sector not only benefits consumer welfare but also has a positive impact in the competitiveness of economy. This has led to several means of intervention that took the shape of formal decisions, market studies and Recommendations to the Government, as well as active contribution to discussions in several international *fora*. The experience in Portugal has provided undisputed evidence that competition issues in the energy sector frequently derive from the existing market structure.

In this paper, we give a brief overview of some of those activities that underline the important role that competition law enforcement and advocacy have played in promoting competition in the energy sector in Portugal.

## **II. Market monitoring and sector specific studies**

In the energy market, as in other sectors of economy, the PCA has extensively used its regulatory and advocacy tools in order to prevent distortions of competition.

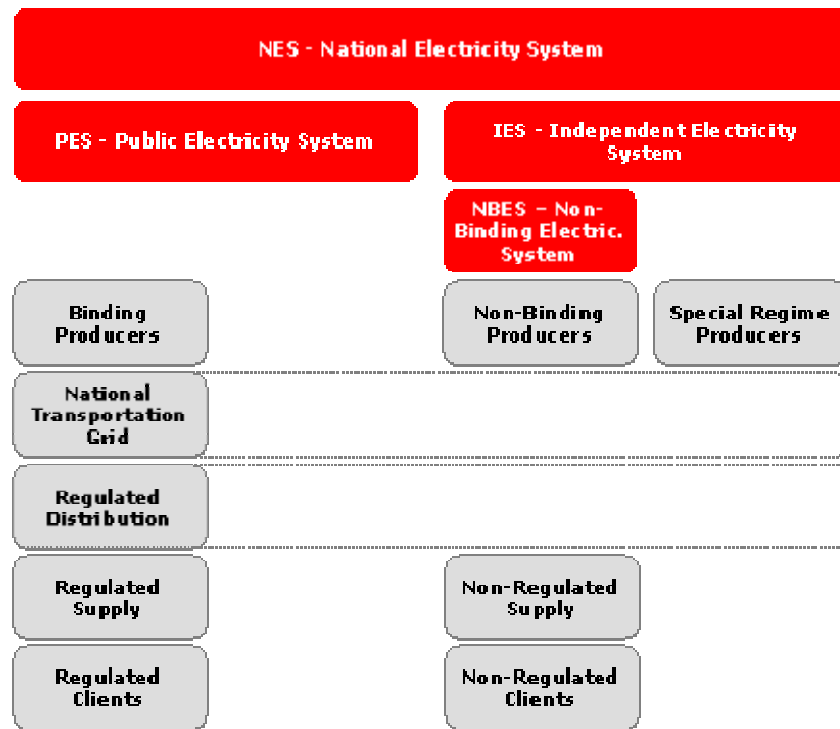
Furthermore, the PCA considers that as an independent agency it can provide policy decision-makers scientific input and further recommendations concerning envisaged or already in force legislative and political measures, as it has occurred in the gas and electricity markets and fuel sector.

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<sup>1</sup> The first law on competition in Portugal was approved in 1983.

## *Gas and Electricity*

Until 2006, the **National Electricity System (NES)** comprised a Public Service Electricity System (PES) and an Independent Electricity System (IES), the latter organized according to free market principles, as shown below:



Source: EDP – Energias de Portugal <sup>2</sup>.

The PES ensured the supply of electricity in Portugal and its activities were considered a public service. The PES had to comply with standards of service quality and tariff uniformity. The IES included the Non-Binding Electricity System (NBES) and producers under special regime (renewable energies and co-generators) who made deliveries to the PES networks according to specific legislation. In Portugal, there has been liberalization of electricity production (incumbent now accounts for about 50%) and full retail liberalization of electricity supply.

This organization ceased to exist with a new legal framework approved in 2006, putting an end to the power purchase agreements (PPA) framework. The former PES will be entirely replaced by indemnity compensations to the producer. This reform aims at the creation of an organized Iberian market for electricity with sufficient liquidity.

<sup>2</sup><http://www.edp.pt/EDPI/Internet/EN/Group/AboutEDP/BusinessEnvironment/PortugueseElectricitySystem/SistElectNacional.htm>

As to the **natural gas market**, it is important to underline that Portugal has no production. Therefore natural gas is imported from producer countries, like Argelia and Nigeria. Until the end of the emerging market status, the sector in Portugal is regulated through concession contracts for the transport and distribution of natural gas awarded by the Portuguese State. It is foreseen that, until April 2007, at least 33% of the annual gas consumption should be liberalised. Two years later, until April 2009, the supply to non-domestic clients should be open, so that the market is fully liberalised until April 2010.

At present, the distribution network in Portugal comprises six concession areas and seven autonomous distribution grids. The concession areas are connected to the transmission network whereas the autonomous grids are supplied through auto tanks in less populated regions<sup>3</sup>.

The National Strategy for Energy approved by the Government in 2005<sup>4</sup> defines the fundamental policy for the energy sector setting as main objectives:

1. To ensure security in the supply of energy, through the diversification of primary resources and energetic services and the promotion of energetic efficiency;
2. To stimulate and promote competition, as a way to increase consumer welfare as well as competitiveness and efficiency of undertakings;
3. To guarantee environmental adequacy of the energetic process, reducing the environmental impact in a local, regional and global scale.

In 2003, taking in consideration the construction of the Iberian Electricity Market (“MIBEL”), the Portuguese Government announced a restructuring of the energy sector in Portugal, whereby gas transmission would be separated from GALP Energia, operating in the oil and natural gas businesses, and merged with the electricity transmission company REN. Under the framework agreements signed by the Portuguese government and involved parties in February 2004, gas importation, distribution and supply would be controlled jointly by the incumbent electricity operator in Portugal Energias de Portugal - EDP (51%) and the Italian oil company ENI (49%). This two-step operation originated two merger procedures: Case Ccent n° 21/2004-REN/GDP/Rede de Transportes de Gás Natural (TRANSGÁS) dealt by the PCA and Case No. COMP/M.3440 - EDP/ENI/GDP, analysed by the European Commission.

In this context, the PCA decided to undertake a study on the gas and electricity markets in Portugal, commissioned to an independent consultant, Cambridge Economic Policy Associates

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<sup>3</sup> On the subject of access to natural gas transportation and storage infrastructure in Portugal, v. the contribution of the PCA to the Roundtable on Ensuring Access to Key Capacity for New Entrants of the OECD Working Party No. 2 on Competition and Regulation (document DAF/COMP/WP2/WD(2006)15, 26-Jan-2006).

<sup>4</sup> Approved by Resolution of the Council of Ministers No. 169/2005, of 24 October.

LTD (CEPA)<sup>5</sup>. Furthermore, the Study had the purpose of examining the proposed merger, and considering remedies that might be applied to mitigate its effects on competition.

The Study, presented in April 2004, concluded that the structure and business environment for the Portuguese energy markets have a number of characteristics distinguishing them from other European energy markets. Like some other countries, electricity and gas markets are dominated by large companies, which remain partially owned by the state. In these markets, the idea of merging those companies, even with significant remedies, would be difficult to contemplate.

The analysis made showed, however, that:

- while there was a negative impact from restructuring, there were remedies that could mitigate these;
- the development of an effective Iberian energy market would further mitigate the competition issues raised by the restructuring.

In particular, the restructuring provided the opportunity for the resolution of the competition issues associated with the long term power purchase agreements (PPA contracts) that substantially distorted competition in the Portuguese market and under those plans would effectively remain. The independent scientific body thus recommended that serious consideration should be given to imposing a condition on the restructuring that would change the structure of the stranded cost payments.

It was suggested that consideration should be given to imposing conditions including:

- changing the terms of the merger so that GDP - Gás de Portugal assets and contracts are divided into separate independent companies, which are transferred to ENI and EDP;
- requiring EDP in addition to sell additional gas and electricity supply businesses to reduce concentration in energy supply to pre-restructuring levels;
- the release of gas import and interconnect contracts to third parties;
- limiting the construction of new power stations by dominant generators;
- strict regulation of gas distribution businesses, to prevent distortion of investment incentives in gas distribution by the dominant electricity supplier; and
- retention of gas storage within the gas transmission business, and careful regulation of gas storage and LNG (liquefied natural gas) terminal.

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<sup>5</sup> Project Team: Dr Jonathan Mirrlees-Black and Professor David Newbery. Study available at the PCA's website: [http://www.autoridadedaconcorrenca.pt/Download/CEPA\\_FinalReport.pdf](http://www.autoridadedaconcorrenca.pt/Download/CEPA_FinalReport.pdf).

On 9 December 2004, the European Commission adopted a prohibition decision, although commitments were offered by the notifying companies, after having concluded that the acquisition would have strengthened the dominant positions in Portugal of EDP in electricity and of GDP in gas, due to its horizontal and vertical effects. Considering the horizontal effects, the Commission found that the merger would have eliminated future competition between GDP and EDP, whereas in vertical terms EDP would have gained control over supplies to its competitors in the electricity sector. Furthermore, in the gas market, the Commission considered that the merger would have eliminated any demand for gas (associated with EDP) which could have been met by GDP's competitors<sup>6</sup>.

As to the proceedings before the PCA, the merging undertakings withdrew the notification, when an in-depth investigation was still underway.

### *Fuel markets*

In January 2004, the Portuguese government ceased to set motor fuel prices adopting a free, although closely monitored, price system. Since then, the PCA has undertaken regular monitoring of the fuel markets, which has led to the issuance of a quarterly newsletter available in the PCA's website<sup>7</sup> and abundantly quoted by the media.

The ongoing econometric study makes use of a fixed effects panel-based log-linear approach as applied to weekly price data on both Brent and diesel fuel prices and on final pump prices in Portugal, discriminated by outlet type and geographic location.

The PCA has investigated the speed of the adjustment of the national refined product prices to changes in international oil prices and has concluded that internal prices have a period of adjustment significantly higher than that of the majority of European countries. Since late 2005, the newsletter also covers developments in the bottled domestic gas market.

The latest newsletter, published in March 2007, revealed that in Portugal average retail fuel before taxes are higher than EU average. Furthermore the PCA report stated that fuel prices are generally higher in highways and lower in supermarket owned filling stations (see Graphic 1 below).

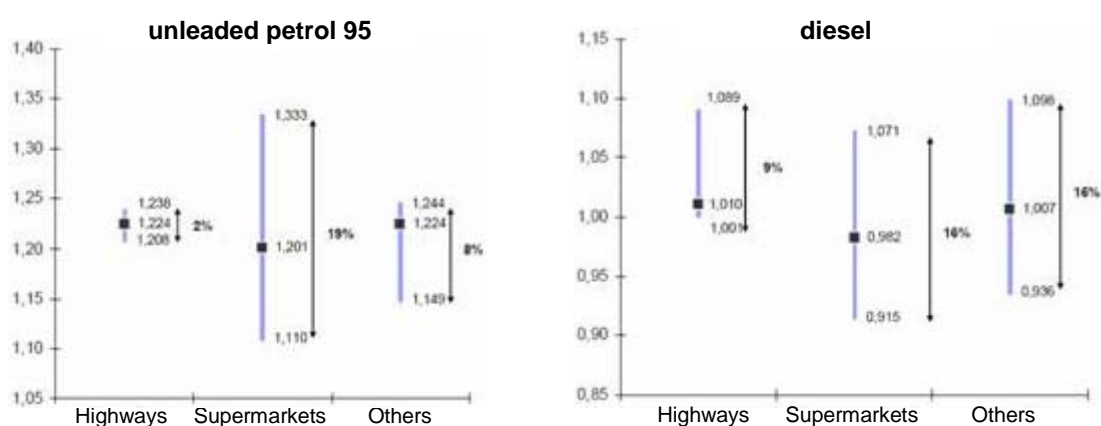
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<sup>6</sup> Bulletin EU 12-2004, Competition (2/13): <http://europa.eu/bulletin/en/200412/p103051.htm>.

<sup>7</sup> Available at:

[http://www.autoridadedaconcorrenca.pt/Aconcorrenca\\_C14.aspx?cat=Cat\\_Publicacoes\\_newsletter&idmenu=4](http://www.autoridadedaconcorrenca.pt/Aconcorrenca_C14.aspx?cat=Cat_Publicacoes_newsletter&idmenu=4)

**Graphic 1: Average retail price variation (unleaded petrol 95 and diesel) 2006**



Source: PCA (based on DGGE data).

Although the pump price liberalisation had just occurred, in 2004 the PCA found that it was necessary to further promote competition in the market. Acknowledging the crucial role played by consumers in choosing the most competitive offer, a broader effort to disseminate information on prices and other conditions of sale among consumers was deemed necessary. Furthermore, supermarkets, acting as non-vertically integrated fuel retailers, play a significant role in promoting competition in the market.

Consequently, the Competition Authority presented a Recommendation No. 3/2004 to the Government concerning the removal of entry barriers for new operators and the dissemination of information at points of sale. Following the PCA's Recommendation, the Government has approved legislation that implements the measures proposed by the PCA (see Box 1).

**Box 1: Recommendation to the Government on the removal of entry barriers for new operators and dissemination of information to consumers in the motor fuel market**

Workable competition can only be achieved if both private and public bodies adopt behaviour and policies consistent with this aim. Therefore, competitive restrictions and distortions resulting from legislation or other actions of public bodies must be prevented.

The PCA presented a systematic set of recommended measures to the Government focusing on different aspects concerning legislation on motor fuel market.

**1. Market access – structural measures**

**a. Access to essential logistical infrastructure**

- Franchises and/or the assignment of the operation of port terminals used or capable of being used for the handling of fuel should always be carried out on the basis of open calls for tender, with a guarantee that their attribution neither creates nor strengthens a dominant position on the market;

- Selection should be based on a transparent and non-discriminatory process, with objective and easily demonstrable criteria;
- The transfer, under any form, of facilities (tanks or land) that are public propriety and that may be used for storing fuel should be carried out by means of a process open to all parties with a possible interest and on the basis of competitive criteria;
- In any of the situations referred to above, the period stipulated for the transfer should not be excessive and should be limited to the minimum that may be demanded for the underlying investments, so as to avoid that the restriction on competition inherent in the resulting closed market is disproportionate in relation to the objectives.

**b. New transport infrastructure**

- It is considered useful to set up a committee of representatives from public and private bodies to study and assess the situation and then present proposals that may improve the structural limitations in this area.

**c. Installation of public filling stations – regulatory changes**

- An amendment to legislation concerning the installation of filling stations is proposed, in order to eliminate all the provisions restricting competition by preventing market access for certain undertakings, in particular, hypermarkets and supermarkets;
- The safety requirements laid down on the legislation for the installation of filling stations should be objective, universally applicable, non-discriminatory and transparent.

**d. The installation of filling stations on motorways**

- Franchise contracts for filling stations in motorways should provide for the obligation of the franchisor to sublease the service areas on the basis of criteria promoting competition and thus avoid creating or strengthening individual or collective dominant positions on each of those roads;
- It should be ensured that the franchises for subsequent stations on the same motorway belong to operators with different brands.

**2. Retail prices: display and transparency – new regulations**

- The legislation should establish the obligation to display the retail prices in effect, in a form easily visible to drivers, in all public filling stations and for all the fuels on sale there;

- Price displays, in accordance with the preceding point, should consist of panels placed on the carriageway, outside the station, so as to allow consumers to make their fuel purchase choices before entering the station;
- For motorways, notices for the retail prices in the various stations along the route should consist of common panels placed at the main entry points and at distances to be defined in the legislation.

**Decree-Law 170/2005, of 10 October**

Following the PCA’s Recommendation, the Government approved legislation imposing that fuel prices should be advertised outside filling stations. In the particular case of highways, signs will be installed informing drivers about fuel prices offered in the next three service stations, as shown in the following picture:



**III. Merger Control**

Merger control has presented several opportunities for the PCA to intervene in the energy market, preventing the creation and, more frequently, the strengthening of already existing dominant positions.

Since 2004, the PCA has examined over twenty merger notifications involving electricity, gas and fuel markets, as shown in the following table.

**Table 1: Decisions of the PCA in merger control**

Sector	Types of decisions				Total
	Approval	Approval with commitments	Prohibition	Other	
Electricity	8	3	-	1	12
Gas	3	1	-	2	6
Fuel	2	-	1	2	5
<b>Total</b>	<b>13</b>	<b>4</b>	<b>1</b>	<b>5</b>	<b>23</b>

Although the majority of the decisions were favourable to the notified mergers, the PCA has prohibited one operation and other four were approved after the parties presented adequate commitments (see Box 2).

Some of the merger operations which have been subject to the scrutiny of the PCA are related to the liberalization process in the energy sector currently ongoing in Portugal.

As an example we can point out the recent decision of the PCA in the merger case REN\*assets<sup>8</sup>. As mentioned before, in view of the construction of the Iberian Electricity Market (“MIBEL”), the redesigning of the energy sector in Portugal foresees the structural separation of the gas incumbent. Hence, gas transmission would be separated from GALP Energia and merged with REN, the undertaking responsible for operating and developing the national transmission network for very high voltage electricity in Portugal (mainland). Furthermore, REN carries out activities involving electric power importation and acts as the sole buyer of electric power in the



National Electricity System, guaranteeing the uninterrupted supply of power.

Notified on 21 June 2006, the merger consisted of the acquisition, by REN, of sole control of a series of regulated natural gas assets then held by GALP, through which it carried out activities involving the transport of high pressure natural gas, underground storage and natural gas regasification.

On 20 July 2006, the PCA decided not to oppose the merger on the grounds that it is not liable to create or reinforce a dominant position that may result in significant barriers to the exercise of the economic activities of natural gas transportation, the underground storage of natural gas and the

regasification of LNG (liquefied natural gas) in Portugal.

After the merger, REN created the undertakings REN Gasodutos, S.A., REN - Armazenagem, S. A., and REN Atlântico, Terminal de GNL, S. A., who will carry out those activities as a concession of public service for 40 years. Therefore, legal unbundling between gas and electricity infrastructure was assured.

<sup>8</sup> Case Ccent 32/2006 – REN\*Assets.

## **Box 2: Merger in the market for the distribution and sale of natural gas**

### **Case Ccent. 48/2003 - EDP/CGD/NQF (Portgás)**

Notified on December 2003, the merger involved the acquisition by EDP of the control of the undertaking NQUINTAS - Projectos e Investimentos, S.A. (N QUINTAS), within the scope of EDP's call option and Caixa Geral de Depósitos (CGD)'s put option and in accordance with the terms of the contract signed by these entities. As relevant assets N QUINTAS holds an indirect investment in PORTGÁS<sup>9</sup>, with shared control, and an indirect financial investment in SETGÁS<sup>10</sup>.

EDP is involved in energy production, distribution and marketing, while CGD is active in banking and finance. N QUINTAS deals with equity investment management in the area of energy and gas.

In 2004, the PCA initiated an in-depth investigation, given that it had observed that the operation could result in significant barriers to competition in the market for the distribution and marketing of natural gas in the northern coastal region.

On September 2004, the PCA decided not to oppose the operation, although subject to the imposition of conditions accompanied by a monitoring obligation. This is was the first time commitments were accepted by the PCA in a merger case.

The PCA will thus, from 2005 and until the year 2010 (or the year in which the PORTGÁS concession agreement terminates, should this be earlier than 2010), follow the expansion in the distribution network and in natural gas consumption within the concession area and the repercussions on PORTGÁS' end consumers of the efficiency gains arising from the merger. Furthermore, the PCA required the commitment of the notifying party to maintain, in the future, the existing legal separation between the undertaking PORTGÁS and EDP.

## ***GAS NATURAL / ENDESA***

The growing integration of the energy markets is also reflected in merger operations. On 21 November 2005, the PCA received the notification of a merger consisting of the acquisition of sole control of ENDESA SA (ENDESA) by GAS NATURAL, SDG, SA (GAS NATURAL)<sup>11</sup>.

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<sup>9</sup> Portgás – Sociedade de Produção e Distribuição de Gás is the concessionaire for natural gas distribution public network in the northern coastal region of Portugal since 1993 and for a period of 35 years, until 2028.

<sup>10</sup> Setgás – Sociedade Produção e distribuição de Gás, SA, is the concessionaire for natural gas distribution public network in the southern region of Portugal since 1993.

<sup>11</sup> Case Ccent. No. 69/2005 – Gaz Natural/ Endesa.

GAS NATURAL is the incumbent natural gas company in Spain, which provides energy services and carries out activities centred on the natural gas (distribution and supply) and electricity sectors. ENDESA is a Spanish group of undertakings, which is active in the business of electricity production, transport, distribution and marketing, including the production of energy from cogeneration and renewable energies. ENDESA also operates in the gas and telecommunications sectors. This company is present in Portugal by way of its holdings in the undertakings Tejo Energia – Produção e Distribuição de Energia Eléctrica SA; T.P. Sociedade Térmica Portuguesa SA; Sodesa – Comercialização de Energia SA; and Finerge – Gestão de Projectos Energéticos SA, which operate in the field of electric power production and marketing. This merger was considered by ENDESA a hostile public offer of acquisition.

On 20 March 2005, the PCA decided to initiate an in-depth investigation, on the grounds that, in the light of the information gathered, the merger may create or reinforce a dominant position that could result in significant barriers to effective competition in Portugal.

This case is an example of application of article 22 of EC Merger Regulation<sup>12</sup>, whereby a Member State may request the European Commission to examine any concentration that does not have a Community dimension within the meaning of that Regulation, but affects trade between Member States and threatens to significantly affect competition within the territory of the Member State or States making the request.

Besides the Portuguese market, the merger in question affected the Spanish and the Italian markets. Therefore, in September 2005, the PCA, later joined by the Italian Competition Authority, asked the European Commission to examine the effects of the merger between GÁS NATURAL and ENDESA in their markets. The Spanish competition authority informed the Commission that it did not wish to join the Portuguese request.

In October 2005, the European Commission decided to reject the request on the basis of not being better placed than the Portuguese and Italian competition authorities to examine the effects of the proposed takeover. The European Commission also rejected ENDESA'S complaint concerning GÁS NATURAL'S failure to notify its proposed takeover to the European Commission, considering that the proposed deal fell outside its jurisdiction<sup>13</sup>.

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<sup>12</sup> Council Regulation (EC) No. 139/2004 of 20 January 2004 on the control of concentrations between undertakings, Official Journal L 24, 29.1.2004, p. 1 – 22.

<sup>13</sup> The Decision of the European Commission was appealed by the Court of First Instance, who rejected the action brought by ENDESA (Judgment of the Court of First Instance in Case T-417/05 Endesa SA v Commission of the European Communities). Endesa then appealed to the European Court of Justice but withdrew it in April 2006 (case C-122/06 P(R)).

The Spanish Government authorized the merger with commitments, despite the negative opinion of the Spanish Competition Court. This decision was then subject to judicial appeals in the Spanish judiciary brought by ENDESA.

In 2007, following the notifying party's request to withdraw from the proceeding, the PCA ruled that the case had terminated.

### ***Renewable Energy Sources***

In the national market for electrical power production, renewable energy sources to produce electricity are becoming increasingly important. There has been active promotion of renewable energy sources and, in 2010, Portugal must assure the production of 39% of its final electric energy with origin in renewable energy sources.

The PCA has analysed three mergers that involved the operation of wind farms and the sale of electrical power produced from wind energy<sup>14</sup>. All these mergers involved ENERNOVA, a subsidiary of EDP. Although the mergers were approved, conditions and monitoring schemes were imposed because the mergers could allow a strategic behaviour of inducing a reduction of wind energy generation in order to raise prices in the organised market. Therefore, ENERNOVA is obliged not to make strategic use of wind power generating facilities, in particular by inducing shutdowns, with the exception of stoppages for maintenance or other technically justifiable reasons, in order to obtain hypothetical benefits from the distortion of competitive practices in the market. Moreover, ENERNOVA guarantees that it shall maintain the maximum availability for production from wind generation facilities and, accordingly, comply with a set of principles concerning preventive maintenance. Concerning the monitoring mechanism, ENERNOVA must report and justify all episodes in which the downtime of its wind farms occurs for an uninterrupted period of at least one hour, excluding situations of insufficient wind, whenever this represents more than 30% of installed capacity or 50 MW.

## **IV. Interaction with Sector Regulators**

Although the PCA has been granted transversal powers over all sectors of the economy, the Portuguese legal system seeks to ensure that the PCA and Sector Regulators work in close co-operation, through specific provisions in both competition legislation and Sector Regulations. Thus, the PCA is legally bounded to request the relevant sector regulator for opinions in antitrust procedures, as well as in merger cases that may have an impact on regulated sectors. Reciprocally, each Sector Regulator has the specific duty to inform the PCA and supply the

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<sup>14</sup> Cases CCent. No. 16/2005 – Enernova/Ortiga/Safra, CCent. No. 60/2005 - Enernova/Bolores, Eneraltius, Levante, Cabeço das Pedras e Malhadizes e CCent No. 06/2007 - Enernova/Eólica da Alagoa.

essential facts whenever, within the scope of its attributions, appraises issues that may constitute an infringement to the Competition Act.

Furthermore, the relationship between the PCA and sector regulators has evolved beyond strict legal obligations into continuous and fruitful collaboration, the main goals being to improve compliance with mutual legal obligations, promote a better understanding of each Institution's mission and prevent and solve possible overlaps of action.

In the specific case of energy, the PCA has received extensive collaboration in all the merger cases referred to above from the Portuguese sector regulator ERSE – Energy Services Regulatory Authority (ERSE).

On the other hand, the PCA is a member of the Consultative Council of ERSE, the organ of consultation, support and participation in what concerns the definition of the general lines of ERSE operations, including the Plan of Activities of ERSE and other matters related to regulation in the electricity sector and the natural gas sector, such as safety standards and approval and amendments to regulations.

Moreover, although not specifically established in legislation, ERSE has consulted the PCA before approving or amending regulations, including tariff rate regulations. The PCA has provided opinions on those regulations when competition issues might arise.

Finally, the PCA has been consulted by the Government before sector legislation has been approved.

## **V. Concluding remarks**

The energy sector is suffering a profound reform in Portugal, affecting its several dimensions such as electricity, natural gas and motor fuel. These changes aim at liberalizing the sector, in order to ensure security in the supply of energy, through the diversification of primary resources and energetic services and the promotion of energetic efficiency, to stimulate and promote competition, as a way to improve consumer welfare as well as competitiveness and efficiency of undertakings and to guarantee environmental adequacy of the energetic process.

Throughout the liberalization process, the PCA has actively intervened either by promoting market studies or by presenting recommendations to the Government and opinions on legislation. Another important aspect of the work of the PCA has been merger control, in close co-operation with the sector regulator.

The impact of liberalization of any given market in particular lowering prices or raising the number of players is not immediate. Therefore, the competition authorities have an important

role to play in improving existing circumstances, raising consumers' awareness and preventing and sanctioning anticompetitive behaviour.

In its four years of existence, the PCA has seek to act in a systematic fashion, combining advocacy and enforcement tools, in order to promote and protect competition in the energy sector.