

II

(Acts adopted under the EC Treaty/Euratom Treaty whose publication is not obligatory)

DECISIONS

COMMISSION

COMMISSION DECISION

of 14 March 2006

declaring a concentration compatible with the common market and the functioning of the EEA Agreement

(Case COMP/M.3868 — DONG/Elsam/Energi E2)

(notified under document number C(2006) 793)

(Only the English text is authentic)

(Text with EEA relevance)

(2007/353/EC)

On 14 March 2006 the Commission adopted a Decision in a merger case under Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) ⁽¹⁾, and in particular Article 8(2) of that Regulation. A non-confidential version of the full Decision can be found in the authentic language of the case on the website of the Directorate-General for Competition, at the following address: http://ec.europa.eu/comm/competition/index_en.html

I. SUMMARY

(1) This case concerns the acquisition of control by DONG of Elsam, Energi E2, KE and FE.

(2) DONG is the Danish state-owned gas incumbent. Elsam and Energi E2 (E2) are the Danish electricity generation incumbents in West Denmark (Elsam) and East Denmark (E2), respectively. KE and FE are the electricity retail incumbents in the Copenhagen area.

(3) The Decision concludes that the transaction leads to a significant impediment of effective competition, in particular through the strengthening of dominant positions on the following markets

— supply of wholesale gas for Denmark (and potentially also for Sweden),

— gas storage or gas flexibility (irrespective of whether only for Denmark or also for Sweden),

— supply of gas to large business customers and decentral CHPs, as 1 or 2 markets, in Denmark,

— supply of gas to small business customers and/or households, as 1 or 2 markets, in Denmark.

(4) The Decision concludes that the Commitments proposed by the parties sufficiently remedy the competition problems identified. As regards the storage/flexibility market, the main effect of the proposed Commitments emanates from the divestiture of the storage facility in Lille Torup, which will have a positive impact on competition with respect to storage/flexibility in Denmark. As regards the gas wholesale and gas retail markets, the Decision concludes that the gas release programme offered by DONG, in combination with the storage divestiture, is sufficient to remove all competition concerns identified by the Commission as relating to these markets.

⁽¹⁾ OJ L 24, 29.1.2004, p. 1.

- (5) Consequently, the Commission declares the notified transaction compatible with the common market and the EEA Agreement, in accordance with Articles 2(2) and Article 8(2) of the Merger Regulation, and Article 57 of the EEA Agreement.

II. EXPLANATORY MEMORANDUM

1. THE PARTIES

- (6) DONG is the Danish state-owned gas incumbent active in exploration, production, offshore transport and sale of oil and natural gas, as well as storage and distribution of natural gas. It also has minor activities related to wind electricity generation and supply of electricity and heat.
- (7) Elsam and Energi E2 (E2) are the Danish electricity generation incumbents in West Denmark (Elsam) and East Denmark (E2), respectively. They are both active in production and trading of electricity (financial and physical) on the wholesale market and in production of district heating. Since its acquisition of the (East Danish) electricity retailer Nesa in 2004, Elsam also has substantial activities in electricity retailing to household and business customers. Elsam and E2 have, on the one hand, a core ownership of local authorities, and on the other hand, substantial shareholdings by DONG and Vattenfall (in Elsam) and by Nesa and KE (in E2).
- (8) KE and FE supply household and business customers with electricity in the Copenhagen area. They are currently owned by the City of Copenhagen and the City of Frederiksberg, respectively.

2. THE OPERATION AND THE CONCENTRATION

- (9) This part of the Decision describes the proposed operation, constituting a concentration, by which DONG acquires control of Elsam, E2, KE and FE, less certain generation assets of Elsam and E2 that will be attributed to Vattenfall. The asset acquisition by Vattenfall constitutes a separate concentration.

3. LEGAL AND REGULATORY FRAMEWORK

- (10) The Decision discusses the applicable regulatory framework for gas and electricity.
- (11) The Danish natural gas market was first opened to competition for the largest customers on 1 July 2000 with all customers being able to choose supplier since 2004. The onshore gas transmission network and the transmission system operator were fully unbundled in

2004 and is today owned and operated by Energinet.dk, an independent public corporation owned by the Danish state. The onshore transmission network operations are subject to regulated third party access (TPA). Storages and the offshore pipelines connecting the fields in the Danish part of the North Sea with mainland Denmark are both owned by DONG. Access to these infrastructures is obtained by negotiated TPA. TPA rules are supervised by the Danish Energy Regulatory Authority (DERA), an independent supervisory body in the energy sector.

4. RELEVANT MARKETS

A. NATURAL GAS

1. Relevant product markets

- (12) With respect to the relevant product markets in the field of gas, the Commission's market investigation focused on the definition of the markets for gas storage/flexibility, gas wholesale and gas supply.

Market for gas storage and gas flexibility

- (13) With regard to gas storage and/or other gas flexibility tools, the exact product market definition of such a market is left open in the Decision.
- (14) The parties proposed a product market for gas flexibility including storage in dedicated storage facilities, changes in production, international trade, line-pack, switching to other fuels, interruptible contracts and market hubs with forward markets.
- (15) According to the Commission, these different flexibility tools can be divided into five groups, namely:

- storage in dedicated storage facilities,
- interruptibility or other modulation of customers' demand, e.g. of central CHPs,
- flexible supply contracts (irrespective of whether they are based on imports, domestic production or secondary domestic supply contracts),
- flexible trading in gas on hubs or bilaterally (irrespective of whether forward looking or ad hoc),
- line-pack, i.e. storage in transport pipelines by increasing or decreasing the gas pressure in those pipelines.

- (16) The Commission's market investigation showed that, for Denmark, none of the four flexibility alternatives to storage in dedicated storage facilities mentioned above are considered as fully viable or sufficiently developed flexibility alternatives. However, the Commission considers that the question of the relevant product market (either flexibility or storage) can remain open.

Market for gas wholesale supplies

- (17) As regards gas wholesale supplies for Denmark, the Decision concludes that there exists a market for wholesale supplies of gas for Denmark, which comprises all sales:

— irrespective of whether via the GTF, supply contracts or other agreements,

— by physical or contractual importers ⁽¹⁾, re-importers (in case of turnaround gas), producers (if applicable in the future) and traders,

— to other traders (such as supply companies) or to central CHPs (the latter to the extent that they take over at least some of the services regularly provided by a supplier for delivery at the site or intend to resell the gas),

which satisfy the needs of these customers to have access to wholesale gas in Denmark.

- (18) The Commission's market investigation provided strong indications for the existence of a separate market for wholesale supplies of natural gas. In its reply to the Article 6(1)(c) decision, DONG recognised 'the existence of gas sales and trading at the wholesale level' and did not contest this or the above product market definition relating to the wholesale market in their reply to the Statement of Objections.

- (19) The proposed transaction also has an impact on wholesale in Sweden. The Decision concludes that there exists a separate market for wholesale supplies of gas destined for consumption in Sweden. The reasons are that the market situation and conditions for wholesale supplies in Sweden are different from those in Denmark.

⁽¹⁾ In this context, the term 'physical imports' is understood as all deliveries into the Danish onshore system/transmission grid. A Danish producer in the Danish part of the continental North Sea shelf thus only becomes a direct participant in the Danish wholesale market if it delivers the gas into the Danish onshore grid.

Market for supply of natural gas to central CHP plants

- (20) The Decision considers that the supply of natural gas to central CHP plants (i.e. large combined heat and power plants) constitutes a separate market because supply to central CHPs is distinct from the wholesale market. However, a central CHP power producer can enter the wholesale market as a buyer or a seller and entry barriers for wholesalers wanting to supply some segments of retail supply to central CHPs are surmountable.

- (21) Supply to central CHPs is also distinct from other retail supply markets, due to higher flexibility and level of consumption, different demand patterns, prices and contract types, different regulation and the fact that central CHPs are able to directly participate on the wholesale market.

Market(s) for supply of gas to decentral CHPs and to large industrial customers

- (22) The Decision considers that the supply of natural gas to decentral CHPs (i.e. small combined heat and power plants) and the supply of natural gas to large industrial customers constitute one or two different product markets.

- (23) Small business customers do not belong to this product market because of differences in inter alia prices, margins, marketing and distribution channels storage costs, market structure, switching rates and metering requirements.

- (24) The Decision considers that supply to large industrial customers and decentralised CHPs have some similarities (level of gas consumption, types of gas contracts) but also some differences (regularity of demand, different ownership structure, customer loyalty and switching rates).

Market(s) for supplies of gas to households and small businesses

- (25) The Decision considers that there exist(s) one or two separate market(s) for non-metered customers, i.e. customers with an annual consumption below 300 000 m³. Sales to small business customers below 300 000 m³ and household customers may thereby either belong to the same or to different product markets.

- (26) Demand and supply conditions between these two types of customers in Denmark show many similarities (higher gas prices, lower propensity to switch supplier, customer portfolio management tools requirements, standardised general offers, and importance of brand image, market structure, storage costs and high entry barriers). There are also a number of relevant differences (average level of consumption, prices, costs and margins and different marketing strategies).
- (27) The competitive assessment does not differ significantly between these two customer groups and whether or not supplies to households and supplies to small business customers form different segments of the same relevant market or two different relevant markets are therefore left open.

2. Relevant geographic markets

Market for gas storage and gas flexibility

- (28) DONG submitted that the relevant geographic market for gas flexibility tools is wider than Denmark and also embraces Sweden, northern Germany and the Netherlands.
- (29) However, the results of the market investigation showed that the geographic market for storage (or flexibility) is, irrespective of the scope of the relevant product market, limited to Denmark. Main reasons for this conclusion are:
- most flexibility tools are available only on a national level,
 - cross-border flexibility is only available in the form of physical storage, however in Sweden the storage capacity is very small (Sweden depends almost entirely on Danish storage facilities) and the usage of storage facilities in Germany is limited due to the longer transport distances and higher transport costs. During the Commission's market investigation, doubts were expressed concerning the possibility of storage abroad,
 - the parties themselves use local storage facilities for their operations in the Netherlands and Germany.
- (30) As regards the Swedish market for storage/other flexibility tools, the Decision concludes that the market is either Swedish in scope or Danish-Swedish.

Market for gas wholesale supplies

- (31) DONG submitted that the relevant geographic market for gas wholesale supplies is wider than Denmark (or Denmark and Sweden) and also embraces at least Germany.
- (32) The market investigation provides strong indications that the market for wholesale supplies is limited to Denmark. The Decision concludes that Sweden is not part of the same geographical market as Denmark; it forms a separate market which is Swedish or Danish-Swedish in scope since the wholesale supplies in Sweden does not exercise a strong competitive constraint on wholesale supplies in Denmark. Similarly, it is concluded that Germany, the Netherlands and the United Kingdom are not part of the same geographic market as Denmark. The reasons are:
- all gas consumed in Denmark is Danish (offshore) gas,
 - in 2003-05, (commercial) imports represented only less than 12 % of total Danish consumption,
 - as regards transactions that generally do not affect wholesale gas needs in Denmark (i.e. transactions on the Benelux, United Kingdom or Emden hubs), prices appear to have an insufficient impact on wholesale prices in Denmark,
 - the different wholesale players in the different countries mentioned above have considerable different market shares in these countries,
 - the market investigation shows that Danish gas customers have little knowledge about wholesale prices in Germany, and import of gas is considered a weak substitute to purchasing gas on wholesale level in Denmark,
 - wholesale gas suppliers wishing to import gas from Germany to Denmark face significant transport costs, capacity constraints and administrative obstacles.
- (33) In its reply to the Article 6(1) (c) decision, DONG argued that gas deliveries at the German side of the Danish entry/exit point at Ellund belong to the Danish gas wholesale market. On the basis of the results of the market investigation, the Decision leaves open whether these deliveries should be included in the geographic scope of the Danish gas wholesale supply market.

Market for the supply of natural gas to central CHPs

- (34) The market for the supply of natural gas to central CHP plants is likely to be national in scope and may at most include Denmark and Sweden since it cannot be wider than the geographic scope of the wholesale market. Moreover, only parts of the supply needed by central CHPs can be sourced from neighbouring countries.

Market(s) for supply of gas to decentralised CHPs and large industrial customers

- (35) The market or markets for the supply of natural gas to decentralised CHPs and large industrial customers is/are national in scope since there are no direct imports. Moreover, the market structures are clearly different between the neighbouring countries. The existence of substantial price differences between Denmark, Germany, Sweden and the Netherlands further confirms the existence of national markets.

Market(s) for supplies of gas to households and small businesses

- (36) The Decision considers that the market(s) for supply to businesses and household customers in Denmark is not wider than national and possibly still regional in scope. The question of whether the market(s) is/are national or regional can be left open. On the one hand, sales on this market require a national sales- and service office and all suppliers to non-metering customers in Denmark are Danish, Danish companies and there exist large price differences between national markets. On the other hand, only less than 1 % of the customers have so far decided to change supplier. Regional distribution companies therefore still have very large market shares in their respective areas and prices to end consumers are different in the three regional areas. The existence of large differences in market share as well as price differences between regions would normally be indications that regional markets are not integrated.

3. Conclusion on relevant markets in the natural gas sector

- (37) The Decision considers that the following relevant markets exist:

1. the Danish market for storage or alternatively the Danish market for flexibility of natural gas; the Swedish market for storage or alternatively the Swedish market for flexibility of natural gas (Swedish or alternatively Swedish-Danish in scope);
2. the market for wholesale of natural gas for Denmark (Danish in scope); the market for wholesale of natural gas for Sweden (Swedish or alternatively Swedish-Danish in scope);

3. the Danish market for the supply of natural gas to central CHPs; the Swedish market for the supply of natural gas to central CHPs (Swedish in scope or Swedish-Danish scope);

4. the market or markets for the supply of natural gas to large industrial customers and to decentralised CHPs (Danish in scope);

5. the market or markets for the supply of natural gas to small business customers and to households (Danish or regional in scope).

B. ELECTRICITY

1. Relevant product markets

Generation and wholesale of physical electricity; Ancillary services

- (38) An important part of the sales and purchases of wholesale electricity in the Nordic area is conducted via the Nordic electricity power exchange Nord Pool Spot ASA (Nord Pool). In addition to these Nord Pool-based forms of trading of physical electricity at wholesale level, producers/traders and customers also engage in bilateral contracts of physical wholesale electricity.

- (39) The immediate customers of ancillary services are TSOs, who are responsible for maintaining the balance in the grid and for securing supply in emergency situations. The Commission's market investigation has led to clear indications that ancillary services/system services are not easily substitutable with other electricity supply at the wholesale level. Moreover, an operator's share of regulating power may vary significantly over time without any apparent relation to its position on the market for electricity production.

- (40) However, the Decision considers that the precise delimitation of this market/these markets can be left open. Bilateral supplies to customers without a direct access to Nord Pool may or may not constitute a separate product market and the same can be said for ancillary services.

Financial derivatives of electricity

- (41) The Decision considers a separate market for financial electricity, since fundamentally the financial market is about trading of risk while the physical market is about trading of electricity for consumption and therefore not fully substitutable. Whether the distinct financial product of CfDs (or contracts for difference) belongs to the same market or to a separate market is left open.

Electricity retail

- (42) The Decision considers separate markets for supplies to customers with hourly metering requirements and one for customers without metering requirements. This distinction was clearly confirmed by the market investigation. These customer groups pay different prices, consume different products and purchase in different ways.

2. Relevant geographic markets

Wholesale of physical electricity

- (43) The Decision considers that the competitive effects of the merger should be assessed on separate East Danish/West Danish Nord Pool price areas or on a combination of the two areas plus Sweden, since the parties' Nordic activities are almost exclusively limited to Denmark. If the concentration does not lead to negative effects on competition in such combinations of areas then it cannot lead to negative effects in any wider price area.
- (44) All other geographic market definition issues for the wholesale electricity market with regard to the current operation are left open.

Ancillary services

- (45) The Decision regards that ancillary services are national in scope, since these are dependent on immediate and reliable availability within a certain price area and since congestion of interconnectors exist.

Financial derivatives of electricity

- (46) As regards *financial derivatives of electricity*, the Decision considers the market to be at least pan-Nordic as financial derivatives of electricity trading takes place on Nord Pool, while the CfDs could comprise the particular price area only, since companies trading in these products will mainly be the wholesale suppliers and customers in these very price areas.

Electricity retail

- (47) In *electricity retail* markets, the Decision considers that the market for metered customers is national, while for non-metered it is national-regional. There is no direct entry by foreign supply companies, and non-metered customers have largely remained with their local USO supplier.

3. Conclusion on relevant markets in electricity

- (48) The Decision therefore defines the following electricity markets:
1. wholesale of electricity (being East Danish and West Danish respectively or wider);
 2. possibly, bilateral wholesales to customers not having access to Nord Pool (being East Danish and West Danish respectively);
 3. possibly, ancillary services (being East Danish and West Danish respectively);
 4. financial derivatives of electricity (encompassing the Nord Pool area if excluding CfDs);
 5. possibly CfDs (being East Danish and West Danish respectively);
 6. electricity sales to metered (business) customers (being Danish-national);
 7. electricity sales to non-metered (predominantly household) customers (being Danish-national or Danish-regional).

C. OTHER MARKETS

- (49) A number of other markets are affected by the proposed concentration but there is no negative impact on competition, either due to low market shares or no geographical overlaps: District heating (local), Fly ash production (regional scope left open) and CO₂ trading (likely EU-wide).

5. COMPETITIVE ASSESSMENT

PRELIMINARY REMARK ON MINORITY SHAREHOLDINGS

- (50) The Decision examines the argument set out by DONG concerning the effect of pre-merger links between the merging parties and between the merging parties and third parties but finds that, in any event, a consideration of any such effect cannot offset the negative effects of the merger.

A. NATURAL GAS

1. Market for gas storage and gas flexibility

- (51) Based on the market investigation undertaken in this case, the Commission has concluded that DONG currently is dominant in the Danish market for storage/flexibility.

- (52) The Decision considers that access to storage/flexibility is a necessary complement to other gas activities, the market for storage/flexibility is considered adjacent to other gas markets. Even though two separate legal entities within DONG are responsible respectively for storage and trading of gas, the Commission considers that both these activities are pursued with the joint aim of increasing the profitability of the DONG group, and has analysed the effect on the Danish market for storage/flexibility against this background.
- (53) Therefore, the Decision considers that the acquisition of E2 and Elsam as the main independent sources of flexibility in Denmark will give DONG the ability and incentive to reduce its storage needs by replacing the use of its own storage facilities by the use of E2 and Elsam as flexibility sources. At the same time, the flexibility alternatives available to competing gas suppliers will be reduced. As a result, and due to the way the Danish storage tariffs apply, other gas suppliers' storage costs will increase and their ability to exercise competitive pressure on DONG will thereby decrease.
- (54) For these reasons, the Decision concludes that the operation would lead to a significant impediment to effective competition on the possible Danish market for storage or on the possible Danish market for storage/flexibility in particular through the strengthening of DONG's dominant position on such markets.
- (55) As regards the Swedish storage/flexibility market, the Decision concludes that the finding of potential harm in Denmark may in principle be extended to Sweden, but that a detailed assessment of the particular features of the Swedish market is unnecessary considering that the overall assessment of the transaction in independent thereof.
- 2. Market for gas wholesale supplies**
- (56) During the investigation, the Commission and DONG have taken different views as regards the relevance of analysing gas wholesale supplies beyond [...] (*). DONG questioned the relevance of looking beyond a [...] * years horizon. According to the Commission, the gas market is signified by long-term investments in infrastructure and long-term supply contracts, which justifies an analysis including a time-horizon beyond [...] *. However, the Decision concludes that even in the absence of any consideration of the market situation beyond [...] *, the merger will have significant anti-competitive effects on Danish wholesale supplies, through the elimination of the BGI project's constraining impact, and the fact that entry decisions of competitors will be guided by the beginning in 2008 of negotiations of supply contracts with Elsam and E2.
- (57) The Decision concludes that DONG is dominant on the Danish market for gas wholesale supplies, considering that the company's market share was [80-90 %] * in 2004 ⁽¹⁾. The Commission analysed potential competitive constraints on DONG's dominant position from the following five sources:
- operators in the Danish offshore area,
 - imports from Germany south of the DEUDAN pipeline,
 - turnaround of gas at Ellund,
 - a liquid Danish wholesale market, and
 - new pipeline capacity or other import facilities.
- (58) The Decision concludes that these competitive constraints are weak or not sufficiently certain to in the short term constitute an effective constraint on DONG's market position.
- (59) The Decision thereafter examines whether the transaction will lead to a strengthening of DONG's dominant position by the removal of actual and/or potential competition. As regards the E2's and Elsam's commercial interest to become active players in the Danish gas wholesale market, DONG disputes that E2 and Elsam constitute potential competitors and argues that they are not the most important competitive constraints on DONG.
- (60) According to the Commission, it is sufficient that E2 and Elsam constitute important competitive constraints (and not necessarily the most important), the removal of which would lead to competition concerns.
- (61) The Commission's investigation and the Decision conclude that the proposed concentration will remove E2 as an actual competitor, and Elsam as a credible potential competitor to DONG. The Commission's analysis of the five potential competitive constraints mentioned in recital 57 above will not change this conclusion. Moreover, the Decision concludes that Vattenfall's acquisition of a small share of E2's and Elsam's gas-fired power plants will not be sufficient to outweigh the loss of competitive pressure caused by the E2's and Elsam's integration in the DONG group.

(*) Business secret.

⁽¹⁾ As is expected to be [80-90 %] * in the first half of 2005.

(62) In addition to these horizontal effects, the Decision concludes that the transaction will lead to customer foreclosure, and as a result, to a significant impediment to effective competition, due to a vertical integration of DONG with E2 and Elsam, which account for about [20-30 %]* of total Danish consumption. It will thus be more difficult for DONG's competitors to enter Danish gas markets, both as wholesale suppliers and as suppliers of final customers, thereby raising barriers to entry to these markets.

(63) The parties submitted that so far Elsam has sourced from third parties only to a limited extent, since it has only engaged in some swapping and short-term purchasing agreements. The Commission, however, considers that supplies to Elsam by DONG's rivals would at least have constituted a potential constraint on DONG's behaviour.

(64) The Decision concludes that even if the foreclosure effect was limited to the foreclosure of demand from E2, such foreclosure would significantly strengthen DONG's dominant position on the Danish wholesale market through creating further disincentives to third parties entering this market on a significant scale. This is because nearly all independent (non-captive) third party demand for Denmark has so far arisen through E2. The proposed merger will as a result raise entry barriers to the Danish wholesale market because it eliminates a company that has purchased important quantities of natural gas on the wholesale market with a view both of using it internally and of supplying natural gas to other users.

(65) The Decision concludes the proposed concentration removes significant competitive constraints to DONG, on the Danish gas wholesale market. Given DONG's entrenched dominant position on such a market, the proposed transaction is likely to lead to a significant impediment to effective competition, in particular through the strengthening of DONG's dominant position.

(66) As regards gas wholesale supplies in Sweden, DONG has a very strong position also on that market⁽¹⁾. The Decision leaves open the question as to whether DONG is in a position of single or joint dominance in a Swedish or Danish-Swedish wholesale supplies market, since any harmful effects on any of these markets would be derived from a harmful effect the operation would have on the wholesale market for Denmark.

⁽¹⁾ At least [45-55 %]* according to DONG sales strategy for 2005, and [70-80 %]* in 2003, according to a recent decision (556/2004) by the Swedish Competition Authority.

3. The market for the supply of natural gas to central CHPs

(67) The Decision considers that no customer foreclosure or input foreclosure can arise on the markets for supply of natural gas to central CHPs in Denmark and Sweden, since a) at least until 2009 no central CHP customers would suffer harm on either the Danish or the Swedish markets for supply to central CHPs, and, b) CHPs would post 2009 be protected if the functioning of the wholesale market is reinforced through the gas release program proposed by the parties.

(68) As regards potential competition, the Decision concludes that it is not likely that E2 and/or Elsam could be considered potential entrants on the market for supply to central CHPs since it would seem unlikely that other central CHPs would be willing to satisfy its gas needs by supplies from its direct competitors.

(69) The Decision therefore considers that the concentration does not lead to a significant impediment of effective competition on the markets for supplies to central CHPs in neither Denmark nor Sweden.

4. Market(s) for supplies to industrial customers and decentral CHPs

(70) The Decision finds that DONG is dominant and will remain dominant in the foreseeable future with a market share of [60-70 %]* in 2004, which is the latest year with reliable market share data. There is no reason to believe that DONG's market share would fall below 50 % in the foreseeable future.

(71) DONG's dominance upstream in wholesale, storage, offshore gas and import pipes further supports DONG's position in this market/these markets of supply to large business customers and decentralised CHPs, since storage facilities and access to gas are important competitive parameters in the context of supplies to these customer groups.

(72) Furthermore, DONG's competitors cannot challenge DONG's dominance, since HNG/MN and Statoil Gazelle are small companies, since HNG/MN is a financially weak competitor and since there exist strong ties between DONG and HNG/MN.

(73) E.ON and Shell both have a very modest market share in the Danish market(s) for sales to large business customers and decentralised CHPs and E.ON is likely to focus its Nordic efforts on the Swedish market.

- (74) The Decision also finds other indications of DONG's entrenched dominance pre-merger: DONG clearly has the lowest switching rate among the large players on the market. DONG is the best placed company to offer dual fuel products and DONG has been able to develop relatively close relations with a number of decentralised CHPs.
- (75) The Decision finds that the proposed operation strengthens DONG's dominance due to the raising of entry barriers and due to the elimination of potential competition.
- (76) The proposed operation raises entry barriers because it will be more difficult for other players to attain critical size in gas supply if some 20 % of total Danish gas consumption is removed from the market. Moreover, DONG's already privileged access to decentral CHPs will be further strengthened as a consequence of the merger. The merger also raises the risk of gas storage input foreclosure or raising of rivals' costs in connection with storage, which will further increase entry barriers. Furthermore, the concentration is likely to raise entry barriers on wholesale markets thereby making it more difficult for DONG's competitors to source supplies competitively. DONG will post merger also be in a privileged position to offer dual fuel products, whereas other competitors will find it more difficult to match DONG's offer.
- (77) The proposed operation furthermore strengthens DONG's dominance due to elimination of the potential competitors Elsam, E2, Nesa and KE.
- (78) E2 and Elsam both have access to large quantities of natural gas at competitive prices. They also have access to storage and means of flexibility. Moreover, they have the necessary 'energy' brand. A clear majority of respondents to the Commission's market investigation has stated that Elsam and E2 could sell on extra quantities of gas to them. Finally, the Commission has found strong evidence for such entry opportunities and intentions by E2, who has already submitted offers to wholesale regional supply companies in Sweden and Denmark in 2003 and 2004.
- (79) NESAs and KE have strong energy brands and can achieve cost synergies and increased customer loyalty by sales of dual fuel. They have access to a large customer base of industrial customers. Also DONG and Statoil Gazelle considered KE, Elsam and Energi E2 potential competitors on Danish gas markets.
- (80) For these reasons, the Decision concludes that the proposed operation will lead to a significant impediment of effective competition, in particular as a result of the creation or strengthening of dominant positions on the market or markets of the supply of natural gas to large business customers and decentralised CHPs.
- 5. Market(s) for supplies of gas to households and small businesses**
- (81) The Decision finds that DONG is dominant in two regional areas with a market share above [90-100 %] * and that this dominance is reinforced by high entry barriers, DONG's control over storages and access to offshore gas as well as its dominant position on the wholesale market.
- (82) On the alternative assumption of a national market, DONG and HNG/MN are considered joint dominant with market shares of [25-35 %] * and [55-65 %] * respectively. There exist strong ties between these companies. The market is very transparent and any deviation from oligopolistic behaviour could therefore be detected easily. The product is very homogenous and facilitates tacit coordination. There are very high customer loyalty rates which result in high entry barriers. Moreover, there are effective retaliation mechanisms against a deviating oligopolist and a high joint interest in maintaining the status quo.
- (83) The Decision finds that DONG's dominance will be strengthened by raising entry barriers and, to a certain extent, by elimination of potential competition.
- (84) The concentration will raise entry barriers due to higher storage cost and to higher difficulties of achieving critical size and reaching the economies of scale and scope necessary for entry to be financially viable. Furthermore, the operation removes larger customers on different markets whose flexibility could be balanced against the flexibility requirements of household and small business customers. Finally, the likely reduction of liquidity on the Danish wholesale gas market increases the ability of DONG to foreclose access to wholesale gas to its competitors.
- (85) The concentration will eliminate some potential competition from KE and to NESAs, who are electricity retailers, both with a base in the greater Copenhagen area. They have already sales offices, large sales forces, IT equipment and billing systems in place. They have large customer portfolios, which could be built upon with the aim to enter gas retail markets. Both companies also have considerable brand strength both at a national and especially at a regional level. Thus, NESAs and KE do not face the high barriers to entry that most other entrants would meet. [...] *.

(86) On the other hand, many of KE's customers already will have its energy requirements for cooking covered by city gas and their heating requirements covered by district heating. It also has to be taken into account that the bulk of NESAs and KE's electricity customer base could only have been used to compete with HNG/MN whose gas distribution areas geographically overlap with NESAs and KE, and not with DONG.

(87) The Decision also acknowledges that other electricity supply companies could enter the market for supply of gas to small business and household customers, but concludes that KE and NESAs have a special position when it comes to access to gas, that would be difficult for other electricity companies to duplicate.

(88) For these reasons, the Decision concludes that the proposed merger will significantly impede competition on the market or markets for the supply of gas to households and small business customers, irrespective of whether these markets are/this market is defined as regional or as national, in particular through the strengthening of a dominant position.

6. Conclusion on the assessment of the natural gas markets prior to consideration of modifications to the notified concentration

(89) The Decision concludes that the transaction leads to a significant impediment of effective competition, in particular through the strengthening of dominant positions on the following product markets:

- supply of wholesale gas for Denmark (and potentially also for Sweden),
- gas storage or gas flexibility (irrespective of whether only for Denmark or also for Sweden),
- supply of gas to large business customers and decentral CHPs, as one or two markets, in Denmark,
- supply of gas to small business customers and/or households, as one or two markets, in Denmark.

B. ELECTRICITY

(90) The Decision finds that the concentration does not give rise to competition concerns on the electricity market.

1. Electricity wholesale

(91) The Decision finds, that *prima facie* Elsam and E2 hold a dominant position in their respective Nord Pool areas in electricity wholesale whenever these areas are isolated from other Nord Pool areas, since the effective constraint exerted by intra-area windmills and decentral CHPs are low.

(92) However, the horizontal effects of the proposed transaction will most likely be substantially surpassed by the loss of market share due to the Vattenfall conditionally linked divestitures of power plants to Vattenfall in both East and West Denmark, which create a viable competitor to the area incumbents, reducing their market shares substantially. The Decision also concludes that intentions by Elsam and E2 to enter into each other's territories have not been established and that DONG had rejected to enter into electricity generation via a gas-fired power plant. Therefore the Decision concludes that any potential horizontal effects are by far outweighed by the more certain and immediate positive effect of Vattenfall's entry.

(93) As to vertical effects, the Decision finds that DONG is unlikely to raise rivals' costs (gas as input) post merger. A model simulation confirmed that in order for the reduction in output to be of any importance very significant increases in gas prices would be required. Such increases based on *merger-related* vertical effects would not be realistic in light of the competitive constraints which, despite its dominant position, would nevertheless exist on DONG after the merger. This conclusion is reinforced by the remedies offered by DONG which will increase the availability of alternative sources of gas to decentral CHPs after the merger. Furthermore, even if the merged entity post merger had an incentive to seek to increase prices of gas to decentral CHPs, it is unlikely that this would translate into higher electricity prices in light of the increased competition in Denmark East and West brought about by the divestiture of the power plants to Vattenfall.

(94) DONG is also unlikely in the future to be able to exercise any direct influence on decentral CHPs due to the commitment by Elsam to the Danish Competition Authority in March 2004 in connection with the acquisition by Elsam of Nesa, where Elsam and Nesa undertook to divest all their shares in decentral gas-fired CHPs.

(95) The effect of the merger on the otherwise positive impact of the Great Belt Interconnector, connecting East Denmark and West Denmark and expected for 2010 is also examined. It is concluded that in the absence of the merger, the constraint that could be caused through this probably 600 MW interconnector is in any event less than the constraint caused by the entry of Vattenfall in both areas. This has also been confirmed by a model simulation.

(96) These considerations and findings concerning horizontal and vertical effects of the proposed merger also apply to bilateral wholesales of electricity to customers within both East and West Denmark assuming a separate market for wholesale customers who may not have direct access to the Nord Pool wholesale market.

(97) In a wider Nord Pool context, the parties will have market shares below 10 % even on a market encompassing only Sweden and both parts of Denmark.

2. Ancillary services

(98) The Decision finds that pre-merger Elsam and E2 had to face little competition in their respective areas, whereas post-merger DONG will be faced, in each area, with a serious competitor, namely Vattenfall. The merger, therefore, will not lead to competition problem on the possible markets for ancillary services in East Denmark and West Denmark.

3. Financial derivatives of electricity

(99) On a Nordic market for trading in *financial derivatives of electricity* the merging parties have a combined market share of $\leq 10\%$. This small market share dispels all concerns on such a market.

(100) Regarding potential area markets for CfDs for East and West Denmark, E2 and Elsam are clearly the major sellers of CfDs in their respective areas. However, it is to be expected that the divestment of generation assets to Vattenfall will have the effect of introducing Vattenfall as a major seller of CfDs in both East and West Denmark.

4. Retail supply of electricity to business customers

(101) The Decision finds that that the current competition level in the Danish market for electricity supplies to metered customers is high. The merged entity will have a combined market share of $[20-30\%]$ *. After the merger, the merged entity will largely close the gap up to the number one player, EnergiDanmark. Furthermore a number of other competitors are considered viable alternatives by customers.

5. Retail supply of electricity to small standard load profile customers

(102) The operation will also lead to some market share overlaps in the market for retail supply of electricity to small customers. The competitive landscape in this market in Denmark is quite fragmented with only a small number of household customers having so far switched from their incumbent local supplier. On a national, Danish, market DONG will become the largest company, albeit with a limited market share of around $[25-30\%]$ *.

(103) Even though NESA and KE were among the more important companies to which customers have switched, other competitors have comparable customer acquisition rates.

(104) On the assumption of regional markets, the Decision finds that the operation would not lead to a significant strengthening of Nesa's, KE's and FE's positions in their respective incumbency areas since third party competitors such as OK and EnergiDanmark are as well placed competitors to the area incumbents as are the other parties to the merger.

6. Conclusion on competitive assessment for electricity markets

(105) The Decision finds that the concentration does not lead to a significant impediment to effective competition, in particular as a result of the creation or strengthening of a dominant position on either any possible affected market for electricity wholesale, ancillary services, financial derivatives of electricity, retail supply to business customers or electricity supply to small customers.

6. COMMITMENTS

A. DESCRIPTION OF THE COMMITMENTS

1. Storage divestiture

(106) With a view to addressing the competition concerns on the storage/flexibility market, DONG has submitted a commitment to divest before 1 May 2007 its larger gas storage facility in Lille Torup in Jutland. Only the purchaser shall be entitled to sell storage capacity in the Lille Torup storage facility for the gas storage year 2007/08 which runs from 1 May 2007 to 30 April 2008. DONG commits not to acquire, for a period of 10 years from closing of the sale to the purchaser, direct or indirect influence over the whole or part of the storage unless the Commission has previously accepted it.

2. Gas Release Programme

(107) With a view to addressing the competition concerns put forward on wholesale markets, DONG has submitted, as a commitment, a Gas Release Programme in order to make available to third parties natural gas in Denmark. The amount of gas to be released will be 400 mcm per year, (a total of 2 400 mcm), to be auctioned in the years 2006 through 2011 for delivery in the gas years following each auction. The volumes correspond to approximately 10 % of total Danish consumption in 2005. In the event that market conditions change significantly, DONG may, under certain conditions, apply to the Commission to have the Gas Release Programme terminated with respect to the two last auctions. The Gas Release Programme foresees a two-step auction process: in the 'Primary Auction', DONG will make gas available at the virtual trading point/hub in Denmark and, as in a swap, successful bidders will make the same volume of gas available to DONG at one of four specified gas hubs in north-western Europe. Any quantities not sold in the Primary Auction, will be sold in a traditional gas release auction to be held later in the same year. In addition, the Commitments foresee a customer release clause according to which existing direct customers of DONG which participate in the auction process or which purchase gas from a trader/wholesaler who was awarded lots in the auction, are entitled to reduce their contractual purchase obligation vis-à-vis DONG.

B. ASSESSMENT OF THE COMMITMENTS SUBMITTED

1. Effect of the proposed commitments on the storage/flexibility market

(108) The main effect of the proposed Commitments on the storage/flexibility market emanates from the divestiture of the storage facility in Lille Torup. In addition, the Gas Release Programme will increase the liquidity of the Danish wholesale market and thereby also provide new sources of flexibility.

(109) The divestiture of the larger of the two Danish storage facilities which has a capacity of approximately 400 mcm with no capacity reservations exceeding one year, will result in increased competition on this market, whether regarded as a storage market or on a wider market for flexibility. These storage/flexibility volumes amount to more than 57 % of the Danish storage capacity and thereby for a very large part of the overall flexibility available in Denmark.

(110) The divestiture of the Lille Torup storage facility is generally viewed by market participants as having a positive impact on competition with respect to storage/flexibility in Denmark.

(111) A positive impact on flexibility available in Denmark will also emanate from the Gas Release Programme, which thus complements the flexibility offered to the market by the Lille Torup storage facility.

(112) Both elements of the Commitments, i.e. the storage divestiture and the Gas Release Programme, will also have a positive impact on the Swedish markets. Competition between DONG and the future storage operator of Lille Torup will also benefit Swedish storage customers. The same applies to the effects of the Gas Release Programme.

2. Effect of the proposed commitments on the wholesale market for natural gas

(113) The Commission has concluded that the gas release programme offered by DONG, in combination with the storage divestiture, is sufficient to remove all the competition concerns identified by the Commission as relating to the wholesale market.

(114) As to the gas release programme, the quantities offered of 400 mcm per year to be swapped or sold via either the primary or the secondary auction make up approximately 10 % of Danish demand.

(115) First, with regard to customer foreclosure, these quantities will, in combination with the customer release provision, compensate for the volumes which E2 has sourced in the past years on a short-term basis both inside and outside Denmark, and which accounted for approximately 5 % of the Danish demand. The released quantities also compensate for any additional volumes which would potentially have been purchased by both Elsam and E2 prior to the expiry of their long-term supply contracts with DONG in 2009.

(116) The quantities will, secondly, compensate for the elimination of potential competition by Elsam and especially E2. It is, however, difficult to establish with sufficient certainty what quantities would have been sold by these companies in the foreseeable future. However, imports by and for E2 plus all competitors' market shares (except for [...]*) together (i.e. all independent competition to DONG taken together), amounted to about 10 % of Danish demand in 2004.

- (117) It should also be considered that these quantities will include flexibility provisions that will make this gas attractive for all purposes of the Danish wholesale market.
- (118) An element of specific importance is the customer release provision which provides an incentive for the purchasers of this gas to use it in Denmark, facilitates entry, and addresses the customer foreclosure concern.
- (119) Regarding the duration and volume of the gas release programme a large number of market participants have qualified this as sufficient for offsetting the harmful effects of the merger on the Danish wholesale market.
- (120) Also the storage divestiture remedy will have a beneficial effect on the Danish wholesale market. This is because access to non-discriminatory storage capacity independent from DONG is an essential facilitator of third parties' wholesale operations in Denmark.
- 3. Effect of the proposed commitments on natural gas retail markets**
- Market(s) for supplies to industrial customers and decentral CHPs and Market(s) for supplies to small businesses and households**
- (i) *The raising of entry barriers (vertical problems)*
- (121) The Decision finds that the gas release programme remedies any concerns relating to the raising of entry barriers on these markets.
- (122) More specifically, the Gas Release Programme addresses the concern relating to customer foreclosure effect and the attainment of critical size, through the customer release part of the programme. The 400 mcm volume auctioned amounts to 17 % of the market for supplies to industrial customers and decentral CHPs and 45 % of the market for supplies to small businesses and households.
- (123) The annual amount of gas to be released will have an important impact on liquidity on the Danish wholesale gas market and will facilitate the possibility of competitors which are active, or wishing to become active, on these markets to offer dual fuel natural gas/electricity supplies in competition with DONG.
- (124) Any concerns relating to the removal of flexibility of central CHPs as a balancing possibility to the flexibility requirements of suppliers and input foreclosure, are remedied by the flexibility provisions of the Gas Release Programme as well as the divestiture of the Lille Torup storage facility, which introduces competition between the two Danish storages.
- (125) The Decision therefore concludes that as an effect of the undertakings submitted entry barriers will not be higher as compared to the pre-merger situation.
- (ii) *Elimination of potential competition*
- (126) The Decision considers that the overall lowering of entry barriers on these markets will have the effect of offsetting the loss of potential competition on these markets.
- (127) Regarding the Gas Release Programme this is in particular achieved in two ways. First, the improved access to gas under the Gas Release Program with the associated flexibility facilitates entry by other potential competitors. Secondly, the customer release mechanism ensures that potential competitors wanting to enter the Danish gas market(s) who have acquired gas through the Release Programme, will have comparatively easy access to customers.
- (128) Second, the storage divestiture remedy will facilitate entry by introducing competition between the two Danish storages, eliminating the risk of input foreclosure and strengthening overall confidence in non-discriminatory access to storage facilities.
- 7. CONCLUSION**
- (129) The Decision concludes that the proposed concentration with the submitted commitments will not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position.
- (130) Consequently, the Commission declares the notified transaction compatible with the common market and the EEA Agreement, in accordance with Articles 2(2) and Article 8(2) of the Merger Regulation, and Article 57 of the EEA Agreement.