Endesa SA

The early years of the 21st Century were a period of rapid deregulation of Europe's energy markets, first the corporate and then the residential client markets. As the 2008 deadline on enforcing full competition approached, European energy utilities were seeking greater size through a pan-European presence and a more balanced energy-generation portfolio. According to Vittorio Perona of Dresdner Kleinwort Wasserstein,

> Some utilities that have been squeezed by commodity prices on the one hand and by consumers and regulators at the other end are beginning to think they should move upstream, to capture a greater share of the energy value-chain margin.[1]

The year 2005 was particularly active in terms of deal making: In August, France's Suez SA increased its share in Belgian power utility Electrabel SA from 51.1 to 100 percent. In September, Germany's E.On AG said it was considering a takeover bid for ScottishPower PLC, the U.K.'s fifth-largest power producer. Meanwhile, France sold shares in its former power monopolies Electricité de France SA Gaz de France SA to public investors.[1]

Then it was Spain's Gas Natural's turn to make a move. Its attempt to acquire Spanish power producer Endesa initiated a three-year saga "with enough plot twists to put a Spanish soap opera to shame."[2] It involved firms, industry regulators, governments, the European Commission, and many, many court decisions in Spain, Luxembourg and the US.

Gas Natural makes a bid

On September 5, 2005, Gas Natural SDG SA, Spain's largest natural gas supplier, offered €22.7 billion ($33.8 billion) for Endesa SA, the country's biggest power producer, twice Gas Natural's size. The cash-and-stock bid, which reflected a 12 percent premium over Endesa's share value, was Gas Natural's second hostile attempt in two years.

Gas Natural's strategy was to create a strong "national champion," a power and gas company capable of competing with Germany's E.ON AG and Électricité de France SA, utilities that were more than twice the size of any provider in Spain. If the acquisition took place, the combined company would be Europe's sixth-largest utility by revenue, with 32 million clients in 16 countries. Antoni Brufau, Gas Natural's vice-chairman and the brains behind the strategy, had previously led Gas Natural's company's unsolicited bid for Iberdrola SA in 2003. The plan was then blocked by regulators. This time, however, Spain's government stated that it would be open to consolidation in the utilities industry.

However, in addition to Endesa's resistance, Gas Natural also had to surpass the barrier of Spanish regulators worried that the merged company might have too dominant a position in Spain. Gas Natural said it expected this would not be problem thanks to a pre-agreed sell-off of some of Endesa's generation assets to Spanish rival Iberdrola.[1]

Written by Professor Luís Cabral for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Rele Adesina, an analyst with West LB in London, wrote in a note to investors that "a merger would be more dignified for Endesa, and we would not expect it to succumb to such aggression without a bitter fight."[3]

Endesa responds to Gas Natural's offer

Endesa was quick to reject Gas Natural's offer, calling it "hostile," "grossly inadequate," and stating the price did not reflect the real value of the company. Manuel Pizarro, Endesa's Chairman, vowed to fight the takeover bid "tooth and nail." In fact, Endesa's board retained J.P. Morgan Chase & Co., Deutsche Bank AG and Citigroup Inc. to help craft its takeover defence. The Spanish stock market regulator, CNMV, placed a first obstacle to Endesa's defense when it issued a gag order on company executives attempting to drum up opposition to the takeover bid. On September 16, Endesa launched a suit against CNMV, which Pizarro justified by stating that

> They are preventing me from speaking to my shareholders. It's what they pay me for, to talk to shareholders.[4]

In addition to Endesa, leaders of Partido Popular, the main opposition to Spain's ruling socialist government, as well as some regional governments and various energy sector players, raised concerns regarding the deal. To this, Gas Natural's Gabarro responded by saying that

> It is time for a rational and serene debate, free of politics and undue emotion, as befits a developed and modern economy keen to maximize growth opportunities,[4]

as well as urging "all parties involved in the process to let the markets freely decide on the merits of the proposal."[4]

Madrid-based Endesa feared that the Spanish government would back Gas Natural. Prime Minister Jose Luis Rodriguez Zapatero was keen on the idea of a "national champion." Moreover, some said he wanted to please his allies in Catalonia: Gas Natural is based in Barcelona, the capital of Catalonia, and since 2004 the Spanish government had received support from Esquierda Republicana de Catalunya, one of the regional political parties.[5] (José Montilla, a minister in the national government, would later become president of the regional government.) Zapatero's view on the deal was crucial because the Spanish government held a golden share in Endesa that essentially gave it final say on the matter.[6]

Reacting to these fears, on September 22 Madrid-based Endesa officially requested that the European Commission assume jurisdiction over the potential deal, claiming that more than one-third of Endesa's business is conducted outside of Spain — one third being the "magic" threshold that triggers oversight by Brussels. The strategy made sense, considering that European Commission regulators had for a while stressed the need for more competition in energy markets. In fact, not long before a European court had upheld the Commission's 2004 ruling that Energias de Portugal (EdP) should not be allowed to take over Gas de Portugal (GdP). Gas Natural quickly denounced Endesa's request that European Union regulators step in, insisting that, contrary to Endesa's claim, more than two-thirds of its business was conducted in Spain.[5]

As an additional defense strategy, Endesa executives promised to raise dividend payments by almost 100% to €7 billion in total for 2005 through 2009, compared with €3.7 billion for 2000 through 2004.[7] Moreover, on October 13, Endesa, which trades on the New York Stock Exchange via American Depository Receipts, filed a complaint with the US Securities and Exchange Commission. The claim was that Gas Natural's main stakeholder, La Caixa, "failed to disclose significant corporate maneuvers that could have influenced third-party investment decisions." La Caixa owned 35.5% of Gas Natural and was a strong backer of the takeover bid.[8]

Enter the Spanish government

On October 6, the Spanish government called for a probe in Endesa's plans to award a special dividend during a takeover period. (In fact, stock market regulator CNMV had already warned Endesa to "refrain from business not considered as ordinary activity, including the payment of special dividends, while the Catalan gas group's bid is still on the table."[9])

Regarding Endesa's appeal to Brussels, Spanish Minister of Industry José Montilla argued that the case should be decided by Spanish regulators, not by the European Union. (The Portuguese government, by contrast, joined Endesa in "requesting that Brussels look into the deal, concerned about the dominant position the resulting company would have."[5]) (On October 18, the European Commission said that "it needed more time to assess whether the proposed takeover fell under its competence or the Spanish regulator's."[10])

The European Commission is out, the Spanish regulator is in

On November 16, the European Commission decided to leave the decision on the takeover for the Spanish authorities to decide upon. The Commission argued that the takeover fell outside its jurisdiction: In 2004, both Gas Natural and Endesa had at least 75% of their EU-wide turnover in Spain, which is well above the 66% threshold set by Article 1 of the Merger Regulation to decide whether the takeover is a European or rather a national issue.[11]

Analysts said the decision removed the last major stumbling block to the deal, leaving it to Endesa's shareholders to decide whether to accept the offer. While some argued that a better offer might be required to win over the target shareholders, Gas Natural had stated at the time of its first offer in September that it would not raise the bid.[11]

The same day the EC recused itself, Endesa's CEO Rafael Miranda said he was appealing the Commission's decision to the Court of First Instance in Luxembourg. Endesa also announced an increased dividend, to be paid out the following January 2.[12]

On January 5, 2006, the Spanish regulator, the Competition Defense Tribunal, recommended that the bid be blocked. The tribunal, whose members were appointed by the previous Popular Party government, voted 6 to 3 against the deal. Fernando Moraleda, a member of the Spanish government, seemed unimpressed:

> There are numerous precedents for the government approving deals where the competition tribunal had recommended against it. We will defend the interest of Spanish industry in a sector which we consider strategic.[13]

Moreover, he said the tribunal's opinion was no more important than a separate antitrust opinion issued the previous month from the National Energy Commission, supporting the acquisition. (Neither opinion bound the government.)

Endesa tries the courts

In a last-ditch attempt to ward off the takeover, on January 13 Endesa made one final plea to the European Court of Justice (ECJ) to acknowledge the European dimension of the case. (Meanwhile, it was still waiting for a response to its request to the EU's Court of First Instance.)[14] On February 1st, the Luxembourg court denied Endesa's application to freeze the deal while the appeal was pending.[15]

As expected, on February 3 Zapatero's government gave Gas Natural the green light (a conditional approval) to its bid for Endesa, effectively ignoring "the fierce objections of the country's own competition tribunal and the misgivings of Europe's competition body."[16] Endesa responded by stating that it was considering filing a suit in the Spanish Supreme Court to block the acquisition. The power company also intensified its media campaign to bring Gas Natural's hostile takeover bid to an international audience. Endesa's ads highlighted its 2005 financial performance and $3.1 billion dividend payout. The ads ran in the US and European editions of *The Wall Street Journal* and *The Financial Times* until March.[17]

Although the government's approval was conditional on 20 conditions, and in spite of Endesa's fierce defense, analysts thought it was a matter of time before the takeover took place. In fact, Endesa's other defenses started to fall apart: Echoing a similar move by the ECJ, Spain's Supreme Court rejected Endesa's request for an injunction placed on the bid.[18]

By mid February, Endesa's management had all but given up hopes of avoiding being taken over; but a few days later the plot was subject to a dramatic twist.

E.ON joins the party

On February 21st, 2006, the market was taken by surprise when German energy giant E.ON tabled an unsolicited €29 billion cash offer for Endesa (a 30% premium with respect to Gas Natural's cash and stock offer). The German company pledged to keep Endesa's headquarters in Madrid and guaranteed there would be no job losses among the Endesa workforce. After an emergency meeting, the Endesa board issued a statement giving a guarded welcome to the bid.[19] The Spanish government, by contrast, stated that

> The government will continue to respect the rules of the market. But it is also its conviction that, in a strategic sector like that of energy, it is in Spain's general interests to have a Spanish-owned company.[20]

Following reports that Zapatero had told E.ON he was seeking legal means of opposing the deal, Brussels warned the Spanish government to stay out of the bid battle, in particular that it avoid using its golden share in Endesa to veto the E.ON bid.[21] Prime Minister Zapatero seemed to agree not to use the government's golden share, but otherwise reiterated his dislike for the German takeover bid:

> Markets are very important but for this Government the citizens are more important ... I understand that Germany wants to have a strong global energy

> company, but so does Spain. The Government is not going to announce any measures. It wants firstly for the markets to play their role, for the rules of the game to function ... The Government has no plans to do anything that involves [using its golden share]. It's an option, but it is not advisable except in truly exceptional circumstances, which, right now, we don't contemplate.[22]

The Spanish government shifts from offense to defense

Other than the golden share, one option open to the Spanish government was to invoke Article 23 of the EU merger law, whereby states can block takeovers for reasons of "public security." However, any attempt to invoke this clause against a respected EU company would shatter Spain's image as an open, modern economy — and undoubtedly provoke legal action by Brussels.[23] Moreover, "opposition to the E.ON bid at the highest political levels could leave Spain exposed to accusations of double standards, especially as Spanish companies" had recently acquired assets overseas, such as mobile phone operator O2 and Abbey National Bank.[22] (A little later Ferrovial bought BAA, the airports operator.)

On February 24, the Spanish government approved rules that would expand the authority of its energy commission to examine acquisitions by foreign companies. José Montilla, the minister of industry, tourism, and commerce, argued that

> The measure basically covers a gap in our laws [which were written when the government had control over Spain's energy companies]. Those instruments that the government used to have are disappearing. We are fixing a deficiency in our laws.[24]

Essentially, the new decree empowered Spain's energy regulator to block a foreign takeover of a Spanish energy company.[25] Later, the Spanish government justified the move by stating that

> Spain could be forced, like other countries, to put in place measures that guarantee security of supply, public safety, and the financial stability of large energy companies. It's the most suitable system for protecting the public interest. Without it, public safety and other interests might be put at risk if the takeover is completed without first assuring that the buyer meets all the conditions to guarantee its compliance with national energy objectives.[26]

The EU reiterated that Spain "must not discriminate on the grounds of nationality [in merger cases]. The chances are that if the Spanish tried to use it to block a merger of a European dimension then it would be illegal." To which Montilla replied that "if Brussels has something to say to us, of course we will take it into account."[24]

The EU reacts to the Spanish government's move

Indeed, Brussels had something to say: On March 6, the European Commission warned Spain that the new measures empowering its energy regulator to block E.ON's bid might contravene internal market rules. In a letter to the Spanish government, Commission Internal Market Chief Charlie McCreevy gave Madrid ten working days to answer a series of questions related to the German-Spanish bid and on a new decree. “In our view, the new national provisions could create obstacles to the right of establishment of nationals of other member states as well as the free movement of capital,” Commission spokesman Oliver Drewes told journalists.[27]

Ten days later, in a direct challenge to the authority of Brussels, Spain’s deputy prime minister Maria Teresa Fernandez de la Vega said that the government respected the Commission’s wish to have a response, but added that an answer was unlikely by the deadline imposed by the EC.[28] Moreover, Spain defended its stance by arguing that governments should be entitled to protect strategic energy assets because of uneven market liberalization across the EU. Specifically, the argument was that market opening was “notably more intense in Spain than in other countries” — specifically, France, Italy and Portugal — where state ownership of energy companies was then still high.[26]

The argument did not sell in Brussels. On April 4, the European Commission voted to pursue legal proceedings against Spanish limits on energy investments. (Other similar suits included France’s decree singling out some sectors from foreign takeovers; and Portugal’s special “golden share” veto right in Portugal Telecom, the subject of an unsolicited offer by Sonae.[29]) The actual suit against the Spanish government was filed in early May.[30]

On July 27, Spain’s energy regulator, the National Energy Commission, approved the E.ON takeover (after repeated warnings by the EU not to block it). However, the Spanish body imposed 19 conditions, including the sale of almost a third of Endesa’s generating capacity in Spain (in particular its coal-fired stations and nuclear plants). E.ON rejected the conditions, thus setting up a potential new clash between Spain and the European Commission.[31] In fact, a few days later the EC fired off a letter of unprecedented severity to the Spanish government, giving Madrid “five working days” to halt its protectionist obstruction of the bid.[32]

On August 10, the European Commission received an answer from Spain to its clarification request regarding the CNE decision.[33] Two weeks later, the Commission issued a statement: “The Commission considers in its preliminary assessment that these conditions violate (EU) rules,” giving Spain a September 13 deadline to answer the Commission’s concerns.[34]

In a September 2006 interview with German newspaper *Die Zeit*, Zapatero took a new tack in explaining his divergence with respect to the European Commision:

> It is Brussels. For Brussels, knowledge of the supply problems of Ceuta and Melilla has no priority. Brussels is equally uninterested in who is present in the energy sector in Latin America. For the Spanish Government, however, that means a great deal, for it is a decisive part of our foreign policy. Brussels does not have to understand everything that happens. It plays its role, adheres to the rules, and makes decisions. Reality is more complex. You will see, however, that there will be a happy end for Spain, for Europe, for the energy sector, and for the power industry.[35]

A few days later, the Spanish government agreed to remove most of the 19 conditions it previously imposed. However, the Spanish Industry, Tourism and Trade Ministry added a condition that parts of Endesa would have to be relisted if E.ON were to be acquired by another rival within ten years of a successful offer for Endesa. The European Commission again warned Spain that such conditions were prohibited by European Union law. “I regret that the Commission has once again been obliged to intervene to avoid that a member state places unjustified conditions on a major European takeover," EU competition chief Neelie Kroes said. The European Commission gave Spain until January 19 to withdraw the new restrictions.[36]

Counter-attack

On February 1, Gas Natural formally bowed out of the race for Endesa. Antoni Brufau, vice-president of Gas Natural, complained it would be impossible to raise Gas Natural's bid to match E.ON's.[37] Analysts at BNP Paribas said that "the likelihood of the [E.ON] deal progressing is now high," and offered "late March or April" as a possible date for its closure.[38]

The long saga for Endesa's control appeared to be at an end. But the Spanish government still had one card to play. Months before, on September 25, 2006, Spanish construction group Acciona had seized 10 per cent of Endesa's shares in an after-hours raid that paid about 26 per cent more than E.ON had been offering. (E.ON then responded by raising its cash offer for Endesa to €35 per share from €25.405.[39]) Moreover, Acciona said it was prepared to raise its share in Endesa up to 24.9 per cent, just below the level that would trigger a compulsory bid under Spanish takeover law.[40]

Spain's economy minister, Pedro Solbes, was then quick to deny suggestions that the Acciona move was intended to undermine E.On's bid. "These movements happen every day. There is no reason to make anything more of it."[41] As to Acciona, their explanation was that "We want to be the biggest shareholder. We want to participate in management. We want to lead Endesa."[2] Nevertheless, many saw this as just another attempt by the Spanish government to block E.ON's bid.

By early January, Acciona already held 21% of Endesa.[42] In early April, a critical meeting took place in Ibiza between Zapatero and Italian prime minister Romano Prodi. Although various political and economic issues were discussed, the meeting (allegedly) had one purpose: finding a strategy to thwart E.ON's bid. On April 11, it became clear what the strategy consisted of: Acciona and Enel, an Italian state-owned power company, formally launched their €43.7 billion offer for Endesa.[43] At €41.30 per share, the operation was dependent on acquiring at least 50.01% of the target; and on Endesa's shareholders rescinding a corporate statute that limited each shareholder's voting rights to 10%. Meanwhile, the Spanish regulator approved the deal but attached twelve conditions designed to safeguard Endesa's independence and prevent the Italian government from influencing Spanish energy policy through its minority stake in Enel.[44]

The regulator that won't go away

On July 5, The European Commission approved Enel and Acciona's joint offer, adding that it would monitor the Spanish energy regulator's review of the deal.[45] In mid September, the EC told Spain that the conditions imposed by CNE on the new proposed takeover (issued in April and July) might break EU merger rules, which give the EC sole competence to rule on mergers with a European dimension.[46]

Three months later, in the beginning of 2008, the EC set a January 10 deadline for CNE to withdraw stipulations imposed on Enel and Acciona's deal. In particular, the

Commission ordered Madrid to lift a requirement on buyers to maintain Endesa as an independent company — including its brand and decision-making center in Spain — and the obligation to keep some electricity assets within Endesa.[47] As Spain would not budge, a mont later the Commission opened infringement procedures.[48]

On March 6, 2008, the European Court of Justice sided with the European Commission when it stated that Spain violated European Union law by placing conditions on the failed E.ON bid for Endesa. The Spanish government reacted by shrugging their shoulders: "The effects of the decision are practically nil as the deal never took place. For this reason the government accepts the decision."[49]

Two months later, the EC scored another point: Spanish Economy Minister Pedro Solbes said that it was "not necessary" to wait until the EU Court of Justice rules before removing the restrictive conditions on Endesa's acquisition by Enel and Acciona. "If the EU is right, then we will have to do it."[50]

The business of politics and the politics of business

The fight for Endesa's control was more than a market race. It involved litigation at various levels: Spain, the EU and the US. More than that, it became a game played by firms and governments, not just firms. "This is politics more than economics at play," said Damien Geradin, a competition law professor at the University of Liége.[51]

The moment the Spanish government decided to block E.ON's bid, it had to balance fighting the takeover with maintaining good relations with the German government. During the 2005 German elections, Zapatero actively sided with the losing candidate, Gerhart Schröder. Nevertheless, in September 2006 the Spanish premier was able to reach an agreement with Chancellor Merkel regarding E.ON's takeover bid for Endesa. The agreement included that the Spanish government withdraw the majority of the 19 conditions it imposed on E.ON, in return for E.ON abandoning "investments in South America."[52] (This was, presumably, the solution Zapatero alluded to in the *Die Zeit* interview he gave a few days before.) But in the game of politics, not all foreign countries are adversaries. In fact, Spain found in Italy an important ally in its attempt to block E.ON's bid.

Endesa also became a new piece in the political chess game of deregulation and neoprotectionism. The EU's goal is that of a market with free movement of people, goods and capital. Not surprisingly therefore, the EC is the main champion in the fight against government intervention, in general and in the energy sector in particular. As EC president José Manuel Barroso said, "We cannot build barriers against each other in a single market — that would be absurd," adding that it is because energy is a "strategic sector that we need a European strategy."[53]

But the pressure also comes from countries, such as Britain, who complain about the lack of reciprocity in the way foreign capital was treated. For example, Vincent Cable, the Liberal Democrats' treasury spokesman, argued that "for a long time Great Britain has benefited from inward investment. Countries like France, Spain and Germany should grow up and learn to accommodate the reality of the global economy." Alan Duncan, the Conservatives' trade and industry spokesman, complained that the Spanish government's actions were unfair: "This is just the sort of behaviour that makes the UK the loser in a game where people are not playing fair."[54]

In fact, the issue of reciprocity came to play a key role in the evolution of the deregulation process. As Xavier Vives of IESE Business School argued, "there can be no fair market for corporate control when some European governments keep stakes in energy firms and others do not."[60] Consistently with this thinking — and against the the tide of EC and ECJ decisions — on October 11, 2008 EU energy ministers, meeting in Luxembourg, agreed on a change of course in the sector's regulation strategy. First, the ministers agreed to opt out of the model of full ownership unbundling of independent system operator (which had been proposed by the EC in its September 2007 package of gas and power market opening laws). Consistently with this shift, the ministers proposed a "level playing field" article whereby governments of unbundled energy systems (such as Spain or the U.K.) could protect unbundled energy firms in the event of takeovers by integrated energy system firms (such as those in Germany or France).[55]

And the winner is . . .

On May 21, 2007 E.ON formally stated that it was dropping its attempt to acquire Endesa and would not make a new takeover offer in the following four years. Wulf Bernotat, E.ON's chief executive, justified the move: "Acciona's and Enel's involvement in Endesa has made our original goal of acquiring a majority stake in Endesa impossible."[56] On August 6, Endesa's board recommended the Enel-Acciona bid to its shareholders: "The board has taken into account that Acciona and Enel's offer is fully in cash."[57]

On October 5, Enel and Acciona clinched their €42.5 billion acquisition of Endesa SA after a tender offer boosted their total holding in Spain's utility to 92%. Under the terms of acquisition agreement, Acciona was to appoint the executive chairman of Endesa, and Enel to appoint the chief executive. Once the deal was complete, Enel held 67% of Endesa and Acciona 25%.[58]

Enel and Acciona also agreed to sell several assets to once-rival-bidder E.ON: most of Enel's electricity business in Spain; all of Endesa's businesses in Italy, France, Poland and Turkey; and some of Endesa's assets in Spain.[59]

The compromise between Enel and Acciona regarding Endesa's board proved to be rather disastrous: the two firms fought over strategy and Endesa suffered from a lack of direction.[60] There was only one solution: On February 20, 2009, Acciona announced that it had reached an agreement to sell its 25.01% stake in Endesa to Enel. The transaction boosted Enel's share to 92%, the balance being held by small investors and investment funds.[61]

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