

**Scottish and Southern Energy's acquisition  
of Atlantic Electric and Gas Ltd**

**A consultation paper**

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# 1. Introduction

1.1 This document:

- gives details of Scottish and Southern Energy plc's completed acquisition of the assets of Atlantic Electric & Gas Ltd (in administrative receivership);
- explains the merger control process for the transaction; and
- requests comments on any regulatory and competition issues arising from the transaction.

## ***Details of the completed acquisition***

1.2 On 28 April 2004 Scottish and Southern Energy plc (SSE) completed the acquisition of the assets of Atlantic Electric & Gas Limited (Atlantic) (in administrative receivership) from the receivers, KPMG LLP for £90.7 million.

1.3 Atlantic is a small independent energy supplier. The company was created in 1999 by Sempra Energy, the US based energy group, which provided it with working capital funding.<sup>1</sup> Atlantic supplies approximately 330,000 customers<sup>2</sup> in the domestic and non-domestic retail sectors throughout Great Britain.

1.4 SSE is a large vertically-integrated energy group and has significant gas and electricity interests in Great Britain. SSE currently supplies more than 5 million gas and electricity customers<sup>3</sup> and is also active in the generation and distribution of electricity and in the transmission of electricity in Scotland. SSE also has interests in energy trading, gas marketing, electrical and utility contracting, and telecommunications.

1.5 As a result of the transaction, SSE will acquire around 330,000 customers, which means that the company will now supply more than 5.5 million customers. SSE,

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<sup>1</sup> Atlantic's Annual Report and Financial Statements 31 December 2002

<sup>2</sup> Data as of 30 April 2004 supplied by SSE.

<sup>3</sup> <http://www.southern-electric.co.uk/aboutcomp/index.asp>

which owns the regional brands Southern Electric, SWALEC and Scottish Hydro-Electric, will retain the Atlantic brand.<sup>4</sup>

### ***Merger control process***

- 1.6 This transaction is subject to the merger control provisions of the Enterprise Act 2002. The OFT has a duty to refer a merger to the Competition Commission if a relevant merger has been created and the merger situation has resulted, or might be expected to result, in a substantial lessening of competition within any market(s) in the UK. A relevant merger is created if the value of the turnover in the UK of the enterprises being taken over exceeds £70 million or the merger results in an increment to the share of supply or consumption of at least 25%. SSE's acquisition of Atlantic creates a relevant merger as Atlantic's turnover exceeds £70 million.
- 1.7 In accordance with the concordat between Ofgem and the OFT, Ofgem will advise the OFT on whether the acquisition could give rise to competition concerns. It will also consider whether the transaction has any implications for the way in which Ofgem carries out its regulatory functions.
- 1.8 Ofgem will take into account information from interested parties in preparing its advice and will forward all submissions to the OFT. In order to allow this information to be considered, Ofgem must receive it no later than 5pm on Wednesday 12 May 2004. Responses to this consultation should be sent to Pamela Taylor ([Pamela.taylor@ofgem.gov.uk](mailto:Pamela.taylor@ofgem.gov.uk)).

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<sup>4</sup> Information from SSE's new release (28 April 2004)

## 2. Issues arising from the completed transaction

- 2.1 In examining mergers, acquisitions or other comparable transactions, Ofgem considers what effect the transaction may have on the level of competition in the relevant parts of the gas or electricity markets. Ofgem also considers whether such transactions have any implications for the way in which it regulates the gas and electricity markets in Great Britain.
- 2.2 In relation to SSE's completed acquisition of Atlantic, Ofgem will consider the effects on competition in both electricity and gas supply.

### ***Impact on competition***

- 2.3 Competition benefits consumers by increasing the pressure on companies to find efficiency savings and to pass them on to their customers, and by driving service innovation. Customer surveys suggest that price is still the key driver of customer behaviour in energy markets, although suppliers have also invested quite considerably in non-price factors (such as innovation in online billing, tariff restructuring and marketing).
- 2.4 In considering the impacts of SSE's acquisition of Atlantic, a key question is the extent to which retail prices might be expected to increase as a result of the transaction. In considering this question, it is important to ignore factors unrelated to the transaction—such as increases in wholesale prices—which might be expected to have an impact on suppliers' cost bases.
- 2.5 The different characteristics of customers and companies' approach to supplying them mean that Ofgem will consider domestic and non-domestic customers separately. In the analysis below a new entrant (in both gas and electricity) is any supplier excluding ex-PES suppliers and British Gas.

### **Market share (concentration)**

- 2.6 A market share test is often used as a proxy for a company's ability to act independently of its customers and competitors (ie, as a proxy for the possession

of market power). The test in merger assessment is whether a substantial lessening of competition is likely to result. It is usual to dismiss as insignificant transactions that have small impacts on market concentration as measured by the HHI index (the sum of the squares of the market shares of all firms).

2.7 A market with an HHI between 1,000 and 1,800 is generally considered to be moderately concentrated, and a rise of over 100 points within that range as a result of a merger is often viewed as potentially raising competition concerns.<sup>5</sup> The position of Atlantic's competitors in the national electricity and gas markets is summarised in table 1 and 2 respectively.

**Table 1: The national electricity market pre- and post-merger<sup>6</sup>**

|             | Domestic |      | Small non-domestic<br>Below 200MWh/year |      | Medium non-domestic<br>200–30,000 MWh/ year |      |
|-------------|----------|------|---|------|---|------|
|             | firms    | HHI  | firms                                   | HHI  | firms                                       | HHI  |
| Pre-merger  | 12 (6)   | 1767 | 14 (9)                                  | 1553 | 10 (8)                                      | 1804 |
| Post-merger | 11 (6)   | 1780 | 13 (8)                                  | 1624 | 9 (7)                                       | 1834 |

note: figures in brackets are the number of firms with a market share greater than 0.5%. Domestic figures use meter points, other figures use volumes

**Table 2: The national gas market pre- and post-merger**

|             | Domestic |      | Small non-domestic<br>Below 50,000 therms |      | Medium non-domestic<br>Over 50,000 therms |      |
|-------------|----------|------|---|------|---|------|
|             | firms    | HHI  | firms                                     | HHI  | firms                                     | HHI  |
| Pre-merger  | 9 (7)    | 4049 | 25 (13)                                   | 2010 | 20 (13)                                   | 1413 |
| Post-merger | 8 (6)    | 4053 | 24 (12)                                   | 2012 | 19 (13)                                   | 1414 |

note: figures in brackets are the number of firms with a market share greater than 0.5%. Domestic figures use meter points, other figures use volumes.

2.8 As can be seen from Table 1 and 2 above, for national gas and electricity markets, HHIs indicate at least moderate concentration. However, the impact of the transaction on concentration is small: the HHI increment in each of the

<sup>5</sup> OFT, Mergers—substantive assessment guidance

<sup>6</sup> Data for domestic markets is from December 2003; data for non-domestic markets is from the calendar year 2002.

markets is less than 100 points. Therefore SSE's acquisition of Atlantic does not significantly alter SSE's position in the market and, on this basis, the acquisition does not seem to raise competition concerns.

- 2.9 Electricity markets possess a number of characteristics that suggest a regional market definition may also be relevant. Since Atlantic's customers are fairly evenly spread across the country, it is Ofgem's view that the acquisition will not have a significant impact on market concentration in any region.
- 2.10 Each of the national markets is discussed in more detail below.

### **Domestic market**

- 2.11 Atlantic is the largest of the new entrants, having achieved 120,000 gas and around 140,000 electricity customers by organic growth.<sup>7</sup> There are 7 other new entrants, of which the largest has significantly fewer customers than Atlantic.
- 2.12 In merger assessment it is sometimes argued that small firms may have an impact on the market that is disproportionate to their market shares. The existence of a 'competitive fringe' may force larger firms to compete vigorously where, in the absence of the 'competitive fringe', less competitive oligopolistic behaviour might be expected.
- 2.13 The loss of an unusual firm in a market may also have a disproportionate effect on competition. For example, a firm which has incentives to pursue a different strategy to other firms as a result of unique characteristics (cost structure or marketing focus) could disrupt potentially oligopolistic behaviour.
- 2.14 Atlantic could, in theory, be regarded as having a disproportionate effect (at least in the domestic market) in that, unlike the six large suppliers in Great Britain, it is not vertically-integrated and, unlike the ex-PES suppliers, it does not have an inherent geographical concentration of customers.
- 2.15 It could be argued that there is a group of small entrants that exert competitive pressure on the six large incumbents, and that the absorption of Atlantic would

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<sup>7</sup> Data supplied by SSE on 30 April 2004

remove or irretrievably weaken this competitive pressure. However, Ofgem's notes that Atlantic's ability to continue growing independently and exert pressure on prices is undermined by the fact it has gone into administration.

- 2.16 There is a range of tariffs available to domestic customers. Ofgem's recent publication "Domestic Competitive Market Review" contains an analysis of price savings available to domestic customers for standard tariffs such as single fuel across all payment methods; dual fuel for both direct debit and standard credit and pre-payment. On the basis of information reported in that review, Atlantic's standard prices for new domestic customers are neither significantly lower than its competitors on average, nor the cheapest in any region.<sup>8</sup>
- 2.17 The acquisition does not have a significant impact on concentration and a number of small suppliers remain active. Ofgem's view is that Atlantic looking forward would not exert an effect on competition disproportionate to its size and, therefore, that the transaction will not have a significant impact on competition.

### **Non-domestic markets**

- 2.18 Ofgem's review of competition in the non-domestic gas and electricity supply sectors published in July 2003<sup>9</sup> explored market definition issues and concluded that, for both gas and electricity, there appear to be three separate markets (small, medium, and large customers). In the non-domestic sector, the markets for supplying small and medium customers with an annual consumption of up to 200 MWh/ year (electricity) and 50,000 therms (gas), and medium customers with an annual consumption of 200 MWh/ year to 30,000 MWh/ year (electricity) and over 50,000 therms (gas) are distinct. Atlantic does not supply any large non-domestic customers.

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<sup>8</sup> 'Domestic Competitive Market Review, A review document', Ofgem April 2004.

<sup>9</sup> 'Review of competition in the non-domestic gas and electricity supply sectors, initial findings', Ofgem July 2003

### **Small non-domestic customer market**

- 2.19 Atlantic has been relatively successful at gaining market share in the small non-domestic market for electricity<sup>10</sup>. However, the acquisition does not have a significant impact on concentration and several small non-vertically integrated suppliers will remain. Ofgem's view is therefore that the acquisition is not likely to have a significant impact on competition in this sector.

### **Medium non-domestic customer market**

- 2.20 Atlantic has a relatively small presence in this market, which means that the completed transaction is unlikely to raise competition concerns for this market.

### ***Regulatory Issues***

- 2.21 Ofgem understands that SSE has not taken on the bulk of the liabilities associated with Atlantic's supply business. These liabilities are expected to include Atlantic's Renewables Obligation (RO) and its obligations under the Energy Efficiency Commitment (EEC). Both of these schemes, important components of the Government's climate change programme, are administered by Ofgem.
- 2.22 According to the provisions of the relevant legislation, compliance with EEC is assessed at the end of the scheme (in 2005) and compliance with the RO is assessed annually in October. Ofgem regards breaches of RO and EEC obligations very seriously. Previous shortfalls in the RO buy-out fund arising from supplier failures (Maverick and TXU) reduced confidence in the ROC market as well as reducing the potential sum available to suppliers.
- 2.23 Ofgem has drawn the possible implications of the administration of Atlantic, in relation to the Renewables Obligation and the Energy Efficiency Commitment to the attention of the DTI and DEFRA.

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<sup>10</sup> According to SSE in April 2004 Atlantic had 62,000 customers in the non-domestic electricity market (includes small and medium customers) and has 7,000 in the non-domestic (includes small and medium customers) gas market.

### ***Summary of Ofgem's initial views***

- 2.24 In the domestic market Atlantic does not currently impose a significant constraint on the behaviour of the six major suppliers.
- 2.25 Irrespective of whether or not Atlantic currently constrains prices in the domestic market, it has gone into administration, indicating that maintenance of its current market position was not sustainable. The relevant counterfactual to the present merger situation would be the transfer of Atlantic's customers to other suppliers under Ofgem's supplier of last resort arrangements.
- 2.26 Ofgem therefore does not expect SSE's acquisition to have a significant impact on competition or prices.
- 2.27 Atlantic's takeover would only result in a marginal increase in concentration in supply of electricity to small non-domestic customers customers. We do not consider that the transaction is likely to give rise to a significant impact on competition in this market. In all other markets the effect is negligible.

### 3. Conclusion

- 3.1 Ofgem is seeking the views of interested parties on SSE's completed acquisition of Atlantic, so that it may advise the OFT.
- 3.2 Responses will normally be made available in the Ofgem library and on the Ofgem website unless respondents request that they should remain confidential. Respondents should mark any part of their response (or the whole response) which is to remain confidential, if this is the case, and where possible should consign any confidential material to appendices. All responses will be copied to the OFT.
- 3.3 Responses should be sent to Pamela Taylor ([Pamela.taylor@ofgem.gov.uk](mailto:Pamela.taylor@ofgem.gov.uk)) by 5pm on Wednesday 12 May 2004.