

March 2002

**British Nuclear Fuels plc's
completed acquisition of Fellside
Heat and Power Limited**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the completed acquisition of Fellside Heat and Power Limited by British Nuclear Fuels plc;
- ◆ explains the merger control process for this transaction; and
- ◆ requests comments on the regulatory issues arising from the proposed transaction.

1.2 Ofgem will make recommendations to the Director General of Fair Trading in relation to the merger. In order to allow comments to be considered Ofgem needs to receive these not later than 5pm on Wednesday 10 April 2002.

2. Details of the proposed acquisition

- 2.1 Fellside Heat and Power Limited (Fellside) is a 168 MW gas fired power station located in Cumbria, England. Prior to this transaction Fellside was a joint venture between British Nuclear Fuels plc (BNFL) and Scottish and Southern Energy plc (SSE). Fellside was owned and operated jointly by BNFL and SSE, with each company holding 50 per cent of the share capital.

- 2.2 On 31 January 2002, BNFL acquired SSE's 50% shareholding, assuming sole ownership and operation of Fellside. BNFL informed the Office of Fair Trading of the completed transaction on 5 March 2002.

3. Merger Control Process

- 3.1 This transaction falls within the scope of UK merger control law since the value of Fellside's assets exceeds the £70 million threshold under the Fair Trading Act 1973 (FTA). The transaction will therefore be assessed under the provisions of the FTA and the Secretary of State for Trade and Industry may refer the transaction to the Competition Commission if the transaction may, in the Secretary of State's opinion, give rise to significant competition concerns.
- 3.2 It is the responsibility of the Office of Fair Trading (OFT), headed by the Director General of Fair Trading (DGFT), to advise the Secretary of State as to whether a transaction should be referred to the Competition Commission. In accordance with the concordat between the OFT and Ofgem, the OFT will consult Ofgem before advising the Secretary of State. Where the OFT advises that the transaction should be referred to the Competition Commission, the OFT may in lieu of such a reference advise that the Secretary of State invites binding undertakings from the parties to the transaction which would remedy any adverse effects on competition identified by the OFT.
- 3.3 If the Secretary of State decides to refer the transaction to the Competition Commission, the Competition Commission has to consider whether the transaction operates, or is likely to operate, against the public interest. If the Competition Commission finds in favour of the transaction, the Secretary of State must clear the transaction. However, if the Competition Commission makes an adverse finding, the Secretary of State may (but he does not have to) take remedial action.
- 3.4 If the Secretary of State decides to clear the transaction, Ofgem will need to consider what modifications might be needed to the licences held by BNFL and Fellside and whether any assurances and/or undertakings are necessary.

4. Details of the Parties

Fellside

4.1 Prior to this transaction Fellside was a joint venture owned and operated by BNFL and SSE, each of whom held 50% of the share capital. Fellside's principal energy businesses include:

- ◆ **electricity generation** - 168 MW gas-fired combined heat and power (CHP) plant located adjacent to BNFL's Sellafield site in Cumbria. Fellside generates electricity which is sold in the England and Wales wholesale electricity market, and steam which is sold to BNFL for use at its Sellafield site;
- ◆ **electricity supply** – an electricity supply licence which authorises supply to BNFL's Sellafield site;
- ◆ **electricity trading** – electricity trading through NETA;

4.2 Fellside's generating capacity of 168 MW is equivalent to 0.25% of capacity in England and Wales and 0.22% of capacity in GB. In 2000/2001, generation output for Fellside was 0.6TWh which represents 0.19% of total output in England and Wales and 0.17% of total output in GB.

SSE

4.3 As a result of the merger of Scottish Hydro-Electric and Southern Electric, SSE is one of the largest vertically integrated energy groups in GB. SSE has significant energy interests and is also involved in utility contracting, environmental control systems and electrical retailing. SSE's principal energy businesses include:

- ◆ **electricity generation** – extensive GB generation interests from a range of sources, including hydro, combined cycle gas turbine and CHP plants. SSE's total generating capacity in England and Wales is 2,318MW (which represents 3.4% of total capacity in England and Wales) and its GB capacity is 5,423MW which accounts for 7% of total GB capacity. In addition, SSE owned 50% of Fellside;

- ◆ **electricity supply** – through wholly owned subsidiaries including SSE Energy Supply Limited and SSE Energy Limited. SSE's supply business includes the ex-PES supply businesses of Scottish Hydro, Southern Electric and SWALEC and supplies around 3.5 million domestic customers and 300,000 I&C customers;
- ◆ **electricity transmission** – ownership and operation of electricity transmission system in the north of Scotland;
- ◆ **gas and electricity trading** – involved in the sale and purchase of gas and electricity in the forward and wholesale markets;
- ◆ **gas supply** – through wholly owned subsidiaries including SSE Energy Supply Limited and Southern Electric Gas Limited. SSE supplies around 1 million domestic customers and 7,700 I&C customers.
- ◆ **gas shipping** – through its wholly owned subsidiaries SSE Energy Supply Limited and Southern Electric Gas Limited.

4.4 SSE's total generation capacity in GB stands at 5,423MW, which represents 7% of total GB installed capacity. In 2001, SSE's generation output was 18.11TWh which represents 5.2% of total GB output.

BNFL

- 4.5 British Nuclear Fuels plc (BNFL) is a public limited company of which 100% of the share capital is held by the Government.
- 4.6 BNFL provides a full range of nuclear fuel cycle and products and services to customers (both GB and international). Its activities include: electricity generation; the procurement of uranium; the manufacture and supply of uranium and plutonium based fuel; reactor design technology and services; and engineering waste management and decommissioning. Within GB its principle energy businesses include:
- ◆ **electricity generation** – through its Magnox Electric plc and British Nuclear Fuels plc electricity generation licences, BNFL currently owns 7 operational Magnox nuclear power stations within GB with a combined

generation capacity of 3002MW. These stations are scheduled to be decommissioned between 2002 and 2010. In addition, BNFL owned 50% of Fellside;

◆ **electricity supply** – electricity supply licence for Magnox Electric plc

4.7 BNFL's Magnox power stations have a combined installed generation capacity of 3,002MW. In 2001 generation output for these stations was 15.3TWh which accounts for 4.4% of GB output.

4.8 Following this acquisition BNFL's capacity will increase from 3,086MW to 3,170MW which represents 4.1% of total GB capacity (an increase of 0.1% in BNFL's position within the sector).

5. Issues arising from the proposed acquisition

Concentration of generation interests

- 5.1 Ofgem considers that there is scope for generators to manipulate the market and so damage competition and/or harm customers. This ability is a result of the special features of the electricity market, including the inability to store electricity other than at very high cost, the complexity of the market rules and relatively inelastic demand and supply, particularly close to real time. Generators may be able to do this despite holding relatively low market shares.
- 5.2 Ofgem will need to consider whether the acquisition of Fellside by BNFL represents a concentration in the generation sector of Great Britain which would have detrimental effects on the development of competition in the generation sector.
- 5.3 In 2001 total generation capacity in GB was 77.7GW (by registered capacity). BNFL accounted for 3,086MW (4%) of that capacity (including its 50% share of Fellside) and the remainder of Fellside for 84MW (0.1%). With regard to generation output within the period BNFL generated 5.1% of total output¹ and Fellside accounted for 0.1% of total output. As a result of this transaction BNFL's combined generation capacity will be 3,170MW an increase of 84MW.
- 5.4 Competition within generation sector has developed well, with 36 companies currently active within the electricity generation sector. BNFL's acquisition of Fellside will not alter BNFL's position within the generation sector. There are a significant number of competitors to BNFL and barriers to entry into the generation sector are relatively low.
- 5.5 Ofgem's initial view is that the small increase in BNFL's market share as a result of the transaction does not appear to raise any competition concerns and does not amount to a considerable concentration in the generation sector. Ofgem welcomes any views on this issue.

¹ Please note this output figure was affected by constraints at a number of sites during the year, including the unavailability of Wylfa plant for much of 2001 (capacity of 980MW) and prolonged outages at two other sites.

6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the acquisition of Fellside by BNFL, so that it may make recommendations to the DGFT.
- 6.2 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.
- 6.3 Comments on the acquisition should be sent, by 5pm on Wednesday 10 April 2002, to:

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