

July 2002

**Centrica plc's completed
acquisition of Regional Power
Generators Limited**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the completed acquisition of Regional Power Generators Limited by Centrica plc;
- ◆ explains the merger control process for this transaction; and
- ◆ requests comments on any competition or regulatory issues relating to electricity and gas arising from the proposed transaction.

1.2 Ofgem will make recommendations to the Director General of Fair Trading in relation to the acquisition. In order to allow comments to be considered Ofgem needs to receive these not later than 5pm on Tuesday 23 July 2002.

2. Details of the proposed acquisition

- 2.1 Regional Power Generators Limited (RPGL) owns a 272MW natural gas combined cycle gas turbine power station at Brigg, North Lincolnshire. Prior to the completed transaction, RPGL was owned by IVO Energy Limited, which is a subsidiary of Fortum Corporation (Fortum), a company incorporated in Finland.
- 2.2 Centrica plc (Centrica) announced its completed acquisition of RPGL on 28 June 2002.

3. Merger Control Process

- 3.1 This transaction falls within the scope of UK merger control law since the gross book value of RPGL'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 Centrica and RPGL and whether any assurances and/or undertakings are necessary.

4. Details of the Parties

Centrica

4.1 Centrica was formed in 1997 by the de-merger of British Gas plc. It is a customer services company with significant energy interests. Its principal energy businesses in the UK include:

- ◆ **upstream interests** – through Hydrocarbon Resources Ltd and Centrica Resources Ltd, including the North and South Morecambe gas fields. Centrica owns both producing and undeveloped fields in the South North Sea and the East Irish Sea, close to Centrica's Morecambe fields operation. The Morecambe Bay field currently supplies 15% of the UK's peak gas demand,¹ and Centrica's remaining production interests produce around 0.7% of marketable UK gas;
- ◆ **electricity and gas trading** – through Accord Energy, which is involved in the sale and purchase of electricity and gas in the wholesale and forward markets;
- ◆ **gas shipping** – through its two licensed wholly owned subsidiaries British Gas Trading Ltd (BGTL) and Accord Energy Ltd, who between them flowed 37% of all gas going through the National Transmission System in 2001/02;
- ◆ **gas supply** – through its wholly owned subsidiary BGTL, with approximately 13.2 million domestic gas customers in Great Britain (GB), representing around a 65% sector share. BGTL also supplies gas to industrial and commercial users, including to gas-fired power stations. Its share of the I&C gas sector is approximately 14% by volume.
- ◆ **electricity supply** – through its two wholly owned subsidiaries BGTL (which holds separate second tier electricity supply licences for its activities in England and Wales and for Scotland) and Accord Energy Ltd, with a total of 5.5 million retail electricity customers in GB, giving it a 21.1% share (by number of meter points). Centrica also supplies just

¹ Source: Centrica website (centrica.co.uk)

over 0.3 million small industrial and commercial customers, giving it a sector share in GB of 12.2%;

- ◆ **electricity generation** – Centrica owns two dual-fired (coal and gas) power stations at King's Lynn and Peterborough, providing a total of 785MW² of generation capacity, or 1.0% of England and Wales (E&W) capacity. It has a 60% share in Humber Power Limited, with a total capacity of approximately 1320MW. In 2001/02, Centrica generated output of 7.7TWh,³ representing 2.5% of E&W (2.2% of GB) output. Centrica's subsidiary, BGTL, has an electricity tolling agreement with Spalding Energy Company Ltd for the whole output of a gas-fired power station which is under construction in Spalding in Lincolnshire and is intended to become operational in 2004. The station will have a capacity of about 860MW (1.1% of GB capacity) – although Centrica has no equity stake in the station;
- ◆ **gas transportation** – Centrica holds an independent gas transporter licence through its subsidiary British Gas Connections Limited (BGCL). In 2001 BGCL made approximately 29 000 new connections, equivalent to 14% of the total number of new connections; and
- ◆ **retailing of central heating equipment and maintenance services** – offering a range of central heating products and a maintenance service for domestic central heating systems and appliances.

- 4.2 Centrica is also involved in fixed and mobile telecoms, through its ownership of One.Tel and British Gas Communications' cooperation agreement with Vodafone. It also owns the AA and provides various financial services through its brand Goldfish.

Fortum

- 4.3 Fortum is a leading Nordic energy company with activities across the energy chain including the production of oil, gas, electricity and heat, as well as energy

² All generation capacity data in this document from NGC 7-year statement for 2001/02.

³ All generation output data in this document from ELEXON.

related engineering, plant operation and maintenance. Fortum's principal energy activities in the UK include:

- ◆ **electricity generation** – Fortum does not have a generation licence, but prior to the completed acquisition owned generation stations at Grangemouth and Glanford Brigg via two wholly owned subsidiaries, Grangemouth CHP Ltd and Regional Power Generators Ltd respectively. Grangemouth power station (registered at 130MW capacity) is currently undergoing the commissioning process and has yet to notify generation to central systems;
- ◆ **gas and electricity trading** – Fortum trades electricity and gas through its wholly owned subsidiaries Fortum Direct Ltd, Fortum Gas Ltd and Fortum Energy Plus, all with negligible shares of the sector (Fortum Energy Plus is the largest, registering around 0.1% of system throughput).
- ◆ **gas and electricity supply** – Fortum is licensed to supply gas and electricity through its subsidiaries Fortum Direct Ltd and Fortum Energy Plus. It supplies a very small number of electricity customers, and supplies approximately 13,000 industrial and commercial gas customers (3.3% of the GB market).

- 4.4 Fortum's total generation capacity in GB, including RPGL, stands at 402MW, which represents 0.6% of total E&W installed capacity (0.5% of GB capacity). In 2001/02, Fortum's generation output was 1.2TWh which represents 0.4% of total E&W output (0.35% of GB output).

RPGL

- 4.5 Prior to the completed acquisition, RPGL was owned by IVO Energy Limited, a subsidiary of Fortum.
- 4.6 RPGL owns a 272MW natural gas combined cycle gas turbine power station at Brigg, North Lincolnshire, which comprises two power station units, each consisting of two turbine generators, two heat recovery boilers and one steam turbine generator. The plant has a generation capacity of 272MW, accounting for 0.4% of total installed E&W capacity (0.3% of GB capacity), and had an output in 2001/02 of 1.2TWh, 0.4% of E&W output (0.35% of GB output).

5. Issues arising from the proposed acquisition

Concentration of generation interests

- 5.1 Ofgem will need to consider whether the acquisition of RPGL by Centrica represents a concentration in generation in England and Wales (E&W) which would have detrimental effects on the development of competition in the sector.
- 5.2 Ofgem considers that there is scope for generators to manipulate the wholesale electricity market and so damage competition and 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 manipulate the wholesale market despite holding relatively low positions in the sector.
- 5.3 In 2001/02 total generation capacity was 67.7GW in E&W (by registered capacity), and 77.7GW in GB. Centrica accounted for 1577MW of that capacity, equivalent to 2.3% of E&W and 2.0% of GB capacity. RPGL accounted for 272MW, i.e. 0.4% of E&W and 0.3% of GB capacity. With regard to generation output within the period, Centrica generated 7.7TWh (2.2% of GB output) and RPGL accounted for 0.35% of total GB output. As a result of this transaction Centrica's combined generation capacity will be 1849MW, an increase of 272MW. Its combined output will be 8.9TWh, or 2.9% of E&W output (2.6% of GB output).
- 5.4 Competition within the generation sector has developed well, with 71 companies currently having a generation licence or owning a subsidiary with a generation licence⁴. Approximately 45 of these actively generated in financial year 2001/02. Six of these companies have at least 5% of E&W output. Centrica's acquisition of RPGL will increase slightly Centrica's position within the generation sector, but it will still only have 2.7% of E&W capacity (2.4% of GB capacity) and 2.9% of E&W output (2.6% of GB output). There are a significant number of competitors to Centrica and competition in electricity generation is well developed.

⁴ Electricity Supply Handbook 2002, Reed Business Information.

- 5.5 Ofgem's initial view is that the small increase in Centrica's market position as a result of the transaction does not appear to raise any competition concerns and does not amount to a significant rise in concentration in the generation sector.

Vertical integration

- 5.6 Centrica is a vertically integrated participant in the gas and electricity supply chains. As a result of the completed transaction, Centrica is increasing the extent of its vertical integration. Ofgem does not regard a vertically integrated position in itself as being against the interests of consumers if competition in the relevant activities is well developed.
- 5.7 Ofgem's initial view is that the completed acquisition does not raise any significant concerns in relation to vertical integration, taking into account the level of competition in the gas supply market (including supply to gas-fired power stations), the levels of competition in the electricity generation and supply markets, and the relatively small increase in the level of its integration as a result of the acquisition. Views are invited from interested parties on competition in this sector.

6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the completed acquisition of RPGL by Centrica, 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, no later than 5pm on Tuesday 23 July 2002, to:

Ben Woodside
Manager, Strategy and Corporate Transactions
Ofgem
9 Millbank
London
SW1P 3GE

Tel: 020-7901-7047
Fax: 020-7901-7077
E-mail: ben.woodside@ofgem.gov.uk