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Scottish and Southern Energy plc's acquisition of Medway Power Ltd

Report to the Office of Fair Trading

Introduction

This note is written in accordance with the Concordat between our two offices to set out Ofgem's views on this transaction so that you may take them into account in deciding whether the merger may result in a substantial lessening of competition.

On October 3 2003, Scottish and Southern Energy plc (SSE) agreed to acquire the equity interests of AES Medway Electric Ltd (AES) and EdF Energy (South East Generation Ltd) in Medway Power Ltd (Medway). SSE, which already owns 37.5% of the equity, will become the sole owner of Medway – a 700 MW combined cycle gas turbine (CCGT) power station on the Isle of Grain in Kent.

SSE will also acquire AES Medway Operations; a wholly-owned subsidiary of AES which operates and manages Medway.¹

Consultation

On October 9 2003, Ofgem placed an overview of the transaction on its website, and invited views on the issues raised by the transaction. Ofgem opted for this more informal approach to consultation due to the short time available for parties to respond together with the lack of obviously significant competition concerns stemming from the transaction.

No responses were received by the deadline of Thursday 16 October. Ofgem's views are set out below.

Ofgem's views

SSE is a large vertically-integrated energy group and has significant gas and electricity interests in Great Britain (GB). SSE supplies over 5 million energy customers² and is active in the transmission of electricity in Scotland and the generation, distribution and supply of electricity and supply of gas in GB. SSE also has interests in gas and electricity trading, gas shipping, metering, connections and contracting services.

Electricity generation

SSE's generation interests include hydroelectric, CCGT and CHP plants. SSE's total generating capacity in E&W is 2,588 MW which represents approximately 4% of the E&W total capacity. This capacity includes SSE's equity share in Medway (pre acquisition) and a share of the capacity of the England-Scotland interconnector. SSE's GB capacity is 4,845 MW which represents approximately 6% of the GB total capacity. For the year ended March 2003, SSE's output in E&W based on equity shareholdings for 2002/03 is approximately 15,000 GWh. If this is amended to reflect contractual positions, SSE's effective output increases to between 17,000 GWh and 20,000 GWh, or around 6% of the total E&W output.

¹ SSE press release (3 October 2003)

² <http://www.scottish-southern.co.uk>

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The generation capacity of Medway is 700 MW, which represents approximately 1% of the total E&W generating capacity. For the year ended March 2003, Medway generated 4,928 GWh, which represents about 2% of the E&W output.³

Ofgem considers that an appropriate geographical market for the analysis of this acquisition is England and Wales (E&W). The Scottish and French interconnectors are included in the analysis as sources of generation for the E&W system. The England-Scotland interconnector almost always flows into the E&W system and the England-France interconnector usually flows into the E&W system.

Market concentration

The acquisition will increase SSE's generation capacity in E&W but Ofgem believes that the addition of 437.5 MW (based on SSE's acquisition of the remaining equity share of Medway (62.5% of 700 MW)) to SSE's portfolio will not give rise to competition concerns.

A useful measure of the concentration in a market is the HHI which has been calculated below for electricity capacity in E&W. For the analysis below we have allocated generation capacity based on equity shareholdings.

	Capacity
HHI pre-merger	831
HHI post-merger	825

The HHI indices above show that the acquisition will reduce concentration in the generation sector in E&W (by reducing the generation capacity shares of EdF Energy and AES).

We have not presented the HHI for output (which is also below 1,000) as the acquisition will not alter the overall output allocation. Pre-acquisition, the output from Medway was contracted equally between SSE and EdF Energy. Post-acquisition, SSE has stated that they will provide a similar amount of power as at present to EdF Energy.⁴

Conclusion

Evidence currently available suggests that the electricity generation sector in GB is competitive at present. Ofgem has noted previously⁵ in its advice to the OFT regarding the proposed arrangements between International Power and Drax that the market shares that may be likely to give rise to competition concerns in the electricity generation sector may be lower than in other sectors due to the inelastic nature of short-run supply and demand in this market. Nevertheless Ofgem's view is that there are no competition concerns arising from the transaction.

³ All capacity numbers are from NGC's Seven Year Statement 2003. Medway's output numbers are from Elexon.

⁴ SSE press release (3 October 2003)

⁵ Proposed arrangements between International Power plc and Drax Holdings Limited – Report to the Office of Fair Trading, October 2003.