

# Scottish and Southern Energy plc's acquisition Atlantic Electric and Gas 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 this acquisition is likely to result in a substantial lessening of competition.

On 28 April 2004 Scottish and Southern 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.

Atlantic is a small independent supplier, created in 1999 by Sempra Energy and has around 330,000 customers<sup>1</sup>. SSE is a large vertically-integrated energy group, which currently supplies over 5 million gas and electricity customers<sup>2</sup>. SSE, which owns the regional brands Southern Electric, SWALEC and Scottish Hydro-Electric, will retain the Atlantic brand.

Ofgem understands that SSE has not taken on Atlantic's licence or responsibility for its Renewable's Obligation (RO) and its obligations under the Energy Efficiency Commitment EEC.

### **Consultation**

On 5 May 2004 Ofgem issued a consultation paper seeking views on the acquisition. Four responses were received. Two responses considered that the transaction is unlikely to result in a substantial lessening competition in any market. Two responses expressed concerns the view that Atlantic had innovated in tariffs and played a vital role in competing with the incumbents. However, one of these responses conceded that SSE's acquisition of Atlantic was preferable to the counterfactual of invoking the Supplier of Last Resort process.

Two responses were particularly concerned by the fact that SSE would not be taking on Atlantic's renewable obligation, which will result in a further shortfall in the RO buy-out fund. One response raised a concern over the financial loss being incurred by suppliers and agents arising from Atlantic's failure to meet its EEC targets.

### **Ofgem's views**

The activities of the companies overlap in the markets for the supply of gas and electricity to domestic customers. In considering the impact of SSE's acquisition of Atlantic, the key question is the extent to which retail prices may be expected to increase as a result of the transaction in the relevant markets. (allowing for other factors which have an impact on suppliers' cost bases- such as increases in wholesale prices).

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<sup>1</sup> Data as of 30 April 2004 supplied by SSE

<sup>2</sup> <http://www.southern-electric.co.uk/aboutcomp/index.asp>

## **Relevant Markets**

The activities of the companies overlap in the domestic and non-domestic gas and electricity supply markets.

### *Domestic*

Atlantic is the largest of the new entrants, having achieved 120,000 gas and around 140,000 electricity customers by organic growth<sup>3</sup>.

### *Non-domestic*

Atlantic has 62,000 non-domestic electricity customers and 7,000 non-domestic gas customers.<sup>4</sup> In accordance with Ofgem's Review of Competition in the Non-Domestic Gas and Electricity Supply sectors in July 2003, Ofgem considers there to be three separate markets: small, medium and large customers (for definitions see table below).

The small customer market encompasses those with an annual consumption up to 20Mh/ year for electricity and 500,000 therms for gas.

The medium customer market includes those with an annual consumption of 200MWh/ year to 30,000 MWh/ year for electricity and over 50,000 therms for gas. Atlantic has a relatively small presence in the medium non-domestic market.

We do not consider the market for large non-domestic customers as Atlantic does not have any such customers.

### *Regional markets*

Electricity markets possess a number of characteristics that suggest a regional market definition. 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 in any particular region.

## **Market Concentration**

The acquisition will increase SSE's share of all of these markets but it is Ofgem's view that this increase has a very minimal impact on the concentration in these markets and does not give rise to concerns that prices will be increased as a result.

A useful measure of concentration in the market is the HHI which has been calculated below. The HHI indices show that the increment in each of the markets is small. Therefore SSE's acquisition of Atlantic does not significantly alter SSE's position in the market.

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<sup>3</sup> Data supplied by SSE on 30 April 2004

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**Table 1: The national electricity market pre- and post-merger<sup>5</sup>**

	Domestic		Small non-domestic		Medium non-domestic	
	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<sup>6</sup>**

	Domestic		Small non-domestic		Medium non-domestic	
	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.

### Effect on competition

Ofgem notes the concerns raised that Atlantic's pricing structure may have had a positive effect on competition and therefore that its removal would be damaging. Atlantic could, in theory, be regarded as having an effect disproportionate to its size in the domestic market in that, unlike the six large supplier in Great Britain, it is not vertically integrated and, unlike other ex-PES suppliers, it does not have an inherent geographical concentration of customers.

<sup>5</sup> Data for domestic markets is from December 2003; data for non-domestic markets is from the calendar year 2002.

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

However, in order to have such an effect, Atlantic would have to be able to exert pressure on the prices of its competitors. According to the information reported in Ofgem's recent publication "Domestic Competitive Market Review"<sup>7</sup>, Atlantic's standard prices for new domestic customers are neither significantly lower than its competitors on average nor the cheapest in any region for new domestic customers.

Furthermore, it seems important to note that Atlantic's ability to continue growing independently and exert pressure on prices is undermined by the fact that it has gone into administration. The relevant counterfactual in this respect is the transfer of Atlantic's customers under Ofgem's supplier of last resort arrangements.

### *Regulatory Issues*

Two of the responses expressed concern over the potential short-fall in the RO buy-out fund due to SSE not taking on Atlantic's Renewable Obligation. One response raised the concern over the financial loss being incurred by suppliers and agents arising from Atlantic's failure to meet its EEC targets.

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. Ofgem considers that these matters do not give rise to competition concerns as a result of the acquisition.

### **Conclusion**

In Ofgem's view SSE's acquisition of Atlantic does not give rise to competition concerns. The impact upon the concentration in each of the relevant markets is minimal and does not increase the ability of SSE to price independently of its competitors. Atlantic does not currently impose a significant constraint on the behaviour of the six major suppliers and it was placed into administration prior to the transaction. It is important to note the relevant counterfactual is the transfer of Atlantic's customers to other suppliers under the supplier of last resort arrangements.

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<sup>7</sup> Domestic Competitive Market review, Ofgem April 2004 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 prepayment.