

October 2001

**E.ON AG's proposed acquisition of
Powergen plc**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the proposed acquisition of Powergen plc by E.ON AG;
- ◆ 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 European Commission in relation to the merger. In order to allow comments to be considered, Ofgem needs to receive these not later than 5pm on 1 November 2001.

2. Details of the proposed acquisition

- 2.1 E.ON AG (E.ON) is a German based energy company formed as a result of the merger of Viag and Veba in 2000. E.ON is active in a number of European energy markets, having interests in electricity generation, and gas and electricity transmission, distribution and supply. It is not at present active in the UK energy market.
- 2.2 Powergen plc (Powergen) is active in the UK electricity generation and energy supply markets and, through its wholly owned subsidiary East Midlands Electricity, operates an electricity distribution network in the east Midlands. Powergen also owns a gas transportation network in the east Midlands, and has upstream and downstream interests in the USA (through the LG&E Energy Corporation).
- 2.3 Under the proposed transaction, which has been notified to the European Commission (and cleared by the Federal Energy Regulatory Commission in the United States), E.ON will acquire Powergen plc.

3. Merger Control Process

- 3.1 Under the European Community Merger Regulation (Council Regulation 4064/89 as amended by Council Regulation 1310/97) ("the Regulation"), a merger having a Community dimension should be appraised by the Commission of the European Union ("the Commission") with a view to establishing whether or not it is compatible with the common market. Because of the parties' combined world-wide and EC turnover, the pre-conditional acquisition of Powergen appears to meet the relevant criteria for a merger having a Community dimension. The Commission has one month from the date of receipt of a complete notification to decide whether the merger raises serious doubts as to the acquisition's compatibility with the common market and whether to initiate an in-depth investigation under Phase II of the Regulation.
- 3.2 Article 9 of the Regulation provides for the Commission to refer a merger to the competent authorities of a Member State where on application of that Member State:
- ◆ a concentration threatens to create or to strengthen a dominant position as a result of which effective competition would be significantly impeded in a market within that Member State, which presents all the characteristics of a distinct market; or
 - ◆ a concentration affects competition in a market within that Member State which presents all the characteristics of a distinct market and which does not constitute a substantial part of the common market.
- 3.3 If a merger is referred back to the Member State under Article 9, the Member State may only take measures strictly necessary to safeguard or restore effective competition in the market concerned. Unless the Commission decides to refer the merger to the UK, the UK will be precluded from applying its national legislation on competition to the merger. The EU Commission then has exclusive jurisdiction to determine whether the proposed acquisition, with or without conditions, does or does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the

common market or a substantial part of it and accordingly whether it is, or is not compatible with the common market.

- 3.4 Article 21 of the Regulation provides for a Member State to take appropriate measures to protect legitimate interests other than those taken into consideration by the Regulation.

4. Details of the Parties

E.ON

- 4.1 As stated above, E.ON is a German based energy company, created in 2000 through the merger of Veba and Viag, which does not at present undertake any electricity or gas activities in the UK. E.ON's principal business interests are:
- ◆ electricity generation - in Germany (via E.ON Energie), the Netherlands (via EZH), and Sweden (via Sydkraft);
 - ◆ electricity transmission – E.ON owns and operates the transmission lines in its traditional supply area in Germany and E.ON Energie, through its affiliates E.ON Scandinavia and Sydkraft, owns Baltic Cable AB, which owns and operates a high voltage power cable connecting the Swedish and German electricity networks;
 - ◆ electricity distribution – E.ON in Germany and Sydkraft in Sweden own and operate regional and local distribution networks (which have no links to the distribution network presently operated by Powergen in the East Midlands);
 - ◆ electricity supply – E.ON supplies electricity to local distribution companies in Germany, Sweden, Denmark and the Netherlands, and supplies electricity directly to domestic, industrial and commercial customers in Germany and Sweden (the latter via Sydkraft);
 - ◆ gas transportation – in Germany, E.ON is active in regional and local transportation, and to some extent short distance wholesale transportation, by supplying some small municipal utilities. E.ON has a small shareholding in Ruhrgas, and holds minority shareholdings in three German companies that are active in long-distance gas transportation (Verbundnetz Gas AG, Ferngas Nordbayern GmbH, and Bayerngas);
 - ◆ gas supply - E.ON Energie, via four regional affiliates, supplies gas mainly to domestic customers in Germany. In Sweden, Sydkraft supplies

gas to local distribution companies and also supplies gas directly to domestic and industrial and commercial customers.

- 4.2 Through E.ON Energie, E.ON has shareholdings and joint ventures in more than a dozen European countries including the Netherlands, Sweden, Switzerland, the Baltic states, Russia, Austria, Hungary, the Czech Republic, and Italy.
- 4.3 In Germany, E.On also has water, heating and engineering businesses, plus interests in coal production and real estate. E.On also has a market presence in a number of unrelated businesses including chemicals, multi-metal distributors, silicon wafers, logistics services, aluminium, oil and petrochemicals (its subsidiary, VEBA Oel AG, is the largest regional oil company in Europe) and packaging. E.ON is in the process of divesting some of its non-core businesses.

Powergen plc

- 4.4 Powergen plc is the holding company for a group of companies which undertake the following activities:
- ◆ electricity generation – through Powergen (UK) plc, Powergen owns or has an interest in 10 power stations in Great Britain with a total capacity of 8,136MW¹;
 - ◆ electricity distribution – Powergen owns and operates, through East Midlands Electricity Distribution Limited, an electricity distribution network in the East to which 2.5 million customers are connected;
 - ◆ gas transportation – Powergen owns and operates a gas transportation network through its subsidiary East Midlands Pipelines Limited;
 - ◆ gas shipping – Powergen ships gas through EME Industrial Shipping Limited, Powergen Gas Limited, Powergen Retail Limited and Powergen (UK) plc;
 - ◆ electricity and gas supply – Powergen supplies gas and electricity to customers nationwide through Powergen (UK) plc and Powergen Retail

Limited. In addition, Powergen Gas (UK) Limited is licensed to supply gas only.

- 4.5 Powergen is also involved in the trading of electricity in Great Britain and is a participant in the electricity balancing mechanism.
- 4.6 Since 1999 Powergen has disposed of a significant amount of generation capacity in England and Wales - nearly 7,000MW of capacity. Following these disposals and acquisitions, Powergen now has a generation market share of around 10.6 per cent of output and 12.1 per cent of total generating capacity in England and Wales².
- 4.7 Powergen, through the licensed supply subsidiaries listed above, supplies energy to 2.2 million customers nationwide. (The great majority of its domestic customers are in East Midlands' former Public Electricity Supply authorised area in the east Midlands.) Powergen has 1.9 million domestic electricity customers in Great Britain, giving it a 7.7 per cent share, and 0.3 million industrial and commercial customers, giving it a market share of 9 per cent. Powergen supplies gas to 0.7 million domestic customers in Great Britain, giving it a 3.5 per cent share, and it has 15,000 industrial and commercial customers, which represents 4.1 per cent of the market.
- 4.8 Powergen Energy Trading Limited, a wholly owned subsidiary of Powergen UK plc, participates on the Nordic Power Exchange and is a member of the Amsterdam Power Exchange. Powergen also owns the LG&E Energy Corporation, a US public utility company, which owns and operates businesses in power generation, retail gas and electricity distribution, gas and oil pipeline equipment, and gas processing.

¹ This includes a 50 per cent shareholding in Corby Power Limited, which owns a 401 MW combined cycle gas turbine power station.

² Powergen's share of the generation market in Great Britain is approximately 9.5 per cent by output and 10.8 per cent by capacity.

5. Issues arising from the proposed acquisition

- 5.1 When examining proposed mergers and acquisitions Ofgem typically considers whether the proposed transaction will have an impact on:
- ◆ competition in relevant markets in the UK;
 - ◆ the ability of a licensee to fulfil its duties under the Electricity and Gas Acts or its licence, and the ability of the Authority to fulfil its duties under the Acts.
- 5.2 Mergers and acquisitions might raise concerns for Ofgem when the purchaser and acquired companies have overlapping activities within the UK. The acquisition of Powergen by E.ON produces no direct overlap of businesses within the UK. However, Ofgem believes that recent developments in gas and electricity suggest that there is an increasing interaction between UK and European gas and electricity sectors. For example, the Bacton-Zeebrugge gas interconnector means that UK gas prices are directly linked to European gas prices, and the direction of flow through the interconnector is affected by the relative UK and European gas prices.
- 5.3 Ofgem will need to consider whether any assurances from E.ON might be necessary to ensure that the proposed transaction does not adversely affect either the ability of the licensed businesses to fulfil their duties under the Electricity and Gas Acts or their licences, or the ability of the Authority to fulfil its duties under the Acts.
- 5.4 Ofgem would welcome views on whether this acquisition raises concerns that may impact upon UK gas prices, and on any other issues affecting whether the transaction should be allowed to proceed.

6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the acquisition of Powergen by E.ON, so that the Authority may make recommendations to the European Commission.
- 6.2 Responses will normally be available in the Ofgem library unless there are good reasons why they must remain confidential. Consultees should mark the part of their response (or whole response) which is to remain confidential, if this is the case, and where possible should consign any confidential material to appendices.
- 6.3 In order to meet the timetable laid down in the Merger Regulations, Ofgem requires comments from interested parties not later than 5pm on 1 November 2001 to:

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