

# **PROPOSED MERGER OF SCOTTISH HYDRO-ELECTRIC plc AND SOUTHERN ELECTRIC plc TO FORM SCOTTISH AND SOUTHERN ENERGY plc**

## **Introduction**

In the light of the joint announcement on 1 September 1998 by Scottish Hydro-Electric plc and Southern Electric plc that they have agreed the terms of a merger of the two companies to form Scottish and Southern Energy plc, the Director General of Electricity Supply (DGES) is issuing a consultation paper about the regulatory issues involved.

The Fair Trading Act 1973 provides that the Secretary of State may refer a qualifying merger or acquisition to the Monopolies and Mergers Commission (MMC). It is the responsibility of the Director General of Fair Trading (DGFT) to advise the Secretary of State as to whether a merger or acquisition should be referred to the MMC. In accordance with the concordat between the Office of Fair Trading and OFFER on regulatory issues, the DGFT will consult the DGES before advising the Secretary of State.

In addition, the DGES needs to consider whether to propose changes to the electricity licences of Scottish Hydro-Electric or Southern Electric, or to exercise any of his other powers under the Electricity Act 1989, in order to take account of issues arising from the proposed merger.

## **Statutory Position on Mergers**

If the DGFT recommends that the Secretary of State refer the merger to the MMC, the Secretary of State may make a reference or instead accept binding undertakings from the parties concerned directed towards remedying or preventing any adverse effects which DGFT has identified.

If a merger reference is made to it, the MMC has to consider whether the merger is likely to have effects adverse to the public interest. If it concludes that a merger would be against the public interest, the Secretary of State has the power to prohibit the merger, or to seek other remedies. There is no power to prohibit a merger if the MMC does not identify any detriment to the public interest.

## **Electricity Act Considerations**

In considering these issues, the DGES is guided by statutory duties. In particular, he must consider the possible implications of a merger or acquisition for the satisfying of all reasonable demands for electricity; the ability of the licensee to finance its authorised activities; the promotion of competition in generation and supply; the protection of

customers in respect of price, continuity of supply and quality of service; and a variety of other considerations set out in Section 3 of the Electricity Act.

The Electricity Act and the public electricity supply (PES) licences impose a large number of significant obligations on licensees. These obligations include duties to develop and maintain an efficient, co-ordinated and economical system of electricity supply; to make use of distribution systems available to competing suppliers, and to establish and operate registration and data transfer services so as to facilitate competition in supply. There are also more detailed requirements concerning price controls, separate accounts, discrimination, cross-subsidy and Codes of Practice. These obligations must be met regardless of ownership. The DGES also needs to ensure that his ability to regulate effectively is not impaired.

### **Issues for Consideration**

If the merger proceeds, it would involve the acquisition of one electricity licensee by another. This would lead to a reduction in the number of independent comparators available for regulatory purposes, including the setting of price controls and standards of performance. It might also lead to a reduction in incentives to efficiency, in view of the protection against take-over afforded by the 'golden share' which HM Government retains in Scottish Hydro-Electric but has relinquished in Southern Electric.

The proposed merger raises issues of concentration in the supply and generation of electricity, with possible implications for competition. The merger would also result in an increase in the extent of vertical integration in the electricity supply industry in England and Wales. Consideration may need to be given to the nature of the contracts entered into by the companies' respective supply and generation businesses, both with each other and with third parties, and to the implications of Scottish Hydro-Electric's generation interests for Southern Electric's own-generation limit. Neither Scottish Hydro-Electric nor Southern Electric is at the forefront of the industry in opening its authorised area to competition in supply and it is for consideration whether the merger may further impede progress by, for example, diverting management attention from this key task.

If the merger were to proceed, Southern Electric would become a subsidiary of Scottish Hydro-Electric. The DGES has made a number of modifications to the PES licences of other licensees that have been taken over to provide continued protection of customers and to maintain regulatory effectiveness. These provisions have come to be referred to collectively as the 'ring-fence'. Following the report of the MMC on the proposed acquisition of The Energy Group plc by PacifiCorp, the DGES published a consultation paper on 24 February 1998 in which he proposed further modifications be made to the PES licences of such licensees to further strengthen the ring-fence. It will be for consideration whether the ring-fence provisions would provide appropriate protections in the present case or whether additional protections might be required.

### **Comments invited**

The DGES will want to consider these issues, as well as any other relevant considerations, in more detail before giving his views to the DGFT. In forming his views, the DGES would find it helpful to receive comments from interested parties by 18 September, 1998

Replies should be addressed to Ms Jackie Sellers, Office of Electricity Regulation, Hagley House, Hagley Road, Birmingham B16 8QG. Replies will be published by being placed in OFFER's library. Any comments relevant to the responsibilities of the DGFT should also be sent to the Office of Fair Trading.

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**Deputy Director General of Electricity Supply**

2 September 1998