

TXU Europe's acquisition of Norweb Energi – a consultation document

Summary

This document:

- ◆ Gives details of the proposed acquisition of Norweb Energi by TXU Europe.
- ◆ Explains the merger control process for this transaction
- ◆ Requests comments on the regulatory issues arising from the proposed transaction.

1. Details of the proposed acquisition

- 1.1 In March 2000, United Utilities announced that it was putting Norweb Energi, its electricity and gas supply business up for sale. Norweb Energi currently provides electricity to approximately 1.85 million customers and supplies gas to 400,000 customers. Following a series of bidding rounds and negotiations, TXU Europe, the holders of the Eastern Electricity PES licence emerged as the successful bidders for Norweb Energi as part of this deal. TXU Europe has assumed responsibility for Norweb Energi's power purchase agreements. The transaction is unconditional, as TXU Europe has assumed the risk of, and responsibility for, obtaining all necessary merger approvals.
- 1.2 A TXU subsidiary, Eastern Energy has awarded a new seven year contract to Vertex, the business processing outsourcing arm of United Utilities, to provide customer services including billing, call centre and income management services to the whole of the TXU retail energy supply business, including the Norweb Energi business.

2. Merger control process

- 2.1 The Fair Trading Act 1973 provides that the Secretary of State for Trade and Industry may refer a proposed merger or acquisition to the Competition Commission. 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 Competition Commission. Where he advises that such a reference should be made, he may also in lieu of such a reference, advise that the Secretary of State should invite binding undertakings which would remedy any adverse effects identified by the DGFT. In accordance with the concordat between the Office of Fair Trading and Ofgem, the DGFT will consult the Director General of Electricity Supply (DGES) before advising the Secretary of State.
- 2.2 If a merger reference is made to the Competition Commission, it has to consider whether the merger operates or is likely to operate against the public interest. If it concludes that the merger would be against the public interest, the Secretary of State has the power to prohibit the merger, or seek remedies. There is no power to prohibit a merger if the Competition Commission does not identify any detriment to the public interest.
- 2.3 If the merger is approved, the DGES would need to consider what modifications might be needed to the licences held by the TXU group and United Utilities and whether any assurances and undertakings are necessary.
- 2.4 The sale of Norweb Energi by United Utilities is unconditional. The purchaser, TXU Europe, has not received merger clearance for the acquisition. Both parties have been in discussions with Ofgem and have agreed assurances to ensure that the Energi business remains intact until merger clearance is granted so that should clearance not be granted the business can be sold on. The assurances also require that until such time as appropriate modifications are made TXU Europe and United Utilities act as if such modifications are in place. These will include changes to Eastern's second tier supply licence to prevent second tier supply to designated customers in the Norweb PES area and to the Norweb second tier supply licence to prevent second tier supply to designated customers in the Eastern PES area.

- 2.5 Should merger clearance not be given, the Secretary of State may require that TXU Europe sell Norweb Energi, or he may make a reference to the Competition Commission.
- 2.6 Should merger clearance be given, Ofgem will seek licence modifications to Norweb's PES licence to ensure that the supply and distribution obligations of Norweb are separated in their licence. Norweb will be required to surrender its second tier electricity supply licence.
- 2.7 Ofgem will also seek licence modifications to Eastern Energy's PES and second tier electricity supply licence. These will be required to include conditions on the distribution business to facilitate competition in generation and supply, and acknowledgement of Norweb Energi's separation programme of supply and distribution in the physical connotations.

3. Details of the Parties

Eastern Group

- 3.1 Eastern Electricity, as part of the TXU Europe Group, is part of a vertically integrated business. It has a supply business, which consists of purchasing electricity, selling it to end users in England and Wales and arranging for its distribution to those end users. TXU Europe Power generates electricity for supply to the electricity Pool in England and Wales and has interests in several power stations in England.
- 3.2 Eastern Electricity has around 3.4 million customers connected to its distribution network. The distribution business recently formed a joint venture company (24:seven) with London Electricity to provide network operations services.
- 3.3 Eastern Electricity has 2.7 million retail electricity customers and 0.7 million gas customers. This is approximately 10.3% of the total electricity market share.

Norweb plc

- 3.4 United Utilities has a range of utility interests. It owns North-West Water which provides domestic and business water and sewerage services to 2.9 million customers. It has a telecoms business, Norweb Telecom, which targets small and medium size enterprises and has developed a business process outsourcing business Vertex, which specialises in customer relationship management. There is also an international operations division which develops and operates contracts to manage water and electricity assets.
- 3.5 Norweb Distribution manages a 59,000-kilometre electricity distribution network which delivers to approximately 2.3 million customers in North West England.
- 3.6 Norweb Energi has 1.8 million electricity customers, approximately 7.1% of the electricity market share and 0.4 million gas customers.

4. Issues arising from the proposed acquisition

4.1 Concentration of supply – should the proposed merger proceed, Eastern Electricity will have approximately 17.4% of the electricity supply market in Britain. The table below shows the electricity market shares of the major electricity suppliers as a result of this proposed transaction.

Name of Company	% share of electricity market	% share of gas market	Combined % share of gas and electricity market
TXU (Eastern and Norweb)	17.4	5.6	11.5
British Gas Trading	10.4	73	41.7
Others	72.2	21.4	46.8
Possible Total Share	100	100	100

4.2 Vertical integration – Ofgem will need to consider whether, given the already vertically integrated nature of TXU's business, the acquisition of Norweb Energi has any material effect. Ofgem will want to ensure that there is no adverse effect on competition. TXU is a vertically integrated company. Vertical integration between generation and supply raises competition concerns if either or both possess market power. The acquisition does not raise any additional concerns in this area as long as there are appropriate competition policies and regulatory tools to deal with market abuse should it arise.

4.3 Contract with Vertex -The sale of Norweb Energi includes a long term contract for the supply of customer relationship services by Vertex, a member of the United Utilities Group. At the same time Eastern Energy have entered into an agreement with Vertex to provide customer relationship services to its customers. Together the contracts total £650m over 7 years. Ofgem has stated, in its decision document on the TXU/London Electricity distribution joint venture, that it does not oppose the outsourcing of services where this is in the interests of efficiency and customer service.

4.4 Non-discrimination - Until supply and distribution activities are separated as required by the Utilities Act, Norweb's PES supply responsibilities in-area will be carried out by an Eastern second-tier supplier on its behalf. Proposed licence modifications include a condition preventing second-tier supply to designated

customers in Norweb's authorised area, and Norweb will be required to surrender its second-tier supply licence.

- 4.5 Information – Eastern's associated generation interests are already ring-fenced from its supply and distribution activities. It is proposed to incorporate the same provisions in Norweb's PES licence.
- 4.6 Competition in generation and supply - It is proposed to incorporate in the PES licences of both Eastern and Norweb restrictions on construction, ownership or operation of generation plant embedded in the licensee's distribution system and a requirement on each distribution business to facilitate competition in generation and in supply within the licensee's authorised area.
- 4.7 Separation – Ofgem will need to re-consider the separation plans for the supply businesses to ensure that they reflect the changes in the company structure, and to consider the need for assurances to extend to include TXU's compliance of separation programme for supply and distribution by Norweb Energi. As with previous mergers, Norweb's licence will need to reflect the sale of its supply business to TXU.

5. Conclusions

- 5.1 The acquisition of Norweb Energi represents a further concentration of supply interests within a vertically integrated company. Ofgem are seeking the views of interested parties so that the Director General of Electricity Supply may make his recommendations to the Director General of Fair Trading.

Comments on the proposed acquisition should be sent, by 18th August 2000 to:

Rachel Graham
Ofgem
6th Floor
16 Palace Street
London
SW1E 5JD

Fax: 020 7932 5197

E-mail: rachel.graham@ofgem.gov.uk