

19 June 2001

**Centrica and TotalFinaElf's
completed acquisition of Humber
Power Limited**

A consultation paper

1. Introduction

Purpose of this document

1.1 This document:

- ◆ gives details of the completed acquisition of Humber Power Limited by Centrica and TotalFinaElf;
- ◆ 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 Director General of Fair Trading in relation to the merger. In order to allow comments to be considered, Ofgem needs to receive these not later than 5pm on Tuesday 3 July 2001.

2. Details of the proposed acquisition

- 2.1 Humber Power Limited (HPL) owns South Humber Bank power station, a natural gas 1260MW combined cycle gas turbine power station near Stallingborough in Lincolnshire. Prior to this transaction, six companies owned HPL: Midland Power; ABB Energy Ventures; Tomen Group; Fortum Group; British Energy and TotalFinaElf (TFE).
- 2.2 TFE has increased its shareholding from 12.5% to 40% in HPL. It has done this by acquiring all the outstanding shares from the other shareholders and subsequently selling 60% of the shares to GB Gas Holdings Ltd, a wholly owned subsidiary of Centrica. As a result of this transaction, Centrica and TFE each have 50% of the voting rights. Centrica will assume the day to-day operation and management of the entire plant.
- 2.3 As part of the transaction, Centrica and TFE will enter into agreements with HPL. Under these agreements Centrica will be entitled to approximately 60% of the power station's total output and TFE will be entitled to the remaining 40%.
- 2.4 The acquisition of HPL was completed on 29 May 2001. The parties have notified the completed transaction to the Office of Fair Trading (OFT) for a decision by the Secretary of State to clear the transaction or to refer it to the Competition Commission for further investigation.

3. Merger Control Process

- 3.1 This transaction falls within the scope of UK merger control law since the value of HPL's assets exceeds the £70 million threshold under the Fair Trading Act 1973 (FTA). The transaction will therefore be assessed under the provisions of the FTA and the Secretary of State for Trade and Industry may refer the transaction to the Competition Commission if the transaction may, in the Secretary of State's opinion, give rise to significant competition concerns.
- 3.2 It is the responsibility of the OFT, headed by the Director General of Fair Trading (DGFT), to advise the Secretary of State as to whether transaction should be referred to the Competition Commission. In accordance with the concordat between the OFT and Ofgem, the OFT will consult Ofgem before advising the Secretary of State. Where the OFT advises that the transaction should be referred to the Competition Commission, the OFT may in lieu of such a reference, advise that the Secretary of State invites binding undertakings from the parties to the transaction which would remedy any adverse effects on competition identified by the OFT.
- 3.3 If the Secretary of State decides to refer the transaction to the Competition Commission, the Competition Commission has to consider whether the transaction operates, or is likely to operate, against the public interest. If the Competition Commission finds in favour of the transaction, the Secretary of State must clear the transaction. However, if the Competition Commission makes an adverse finding, the Secretary of State may (but he does not have to) take remedial action, such as ordering the acquiring companies to divest of HPL.
- 3.4 If the Secretary of State decides to clear the transaction, Ofgem will need to consider what modifications might be needed to the licences held by Centrica and TFE and whether any assurances and, or, undertakings are necessary.

4. Details of the Parties

Centrica

4.1 Centrica was formed in 1997 by the de-merger of the consumer-orientated business of British Gas. It has a core business of gas supply, with its principal energy businesses in the UK including:

- a) gas shipping, through its two licensed wholly owned subsidiaries British Gas Trading Ltd and the energy trading subsidiary Accord Energy Ltd;
- b) gas supply, through its wholly owned subsidiary British Gas Trading Ltd;
- c) electricity supply, through its two wholly owned subsidiaries British Gas Trading Ltd (which holds separate second tier electricity supply licences for its activities in England and Wales and for Scotland) and Accord Energy Ltd; and
- d) Centrica's upstream interests include Hydrocarbon Resources Limited (HRL), a wholly owned subsidiary of BGT. HRL operates the North and South Morecambe gas fields in the Irish Sea. In addition, Centrica Resources Limited operates gas fields in the North Sea.

Centrica is also involved in telecoms, owns the AA and provides various financial services, through its brand Goldfish. Until this transaction was completed Centrica had no generation capacity in the UK, although it does at present have an effective 50% interest in a project to develop a generating facility in Spalding in Lincolnshire. If this project is completed, the expected capacity of the generation facility will be approximately 840MW.

4.2 Centrica currently has 3.74 million retail electricity customers in England and Wales, which gives it a 14.7% share ¹. It currently has around 13.8 million domestic gas customers in Great Britain, representing a 69.4% share.

4.3 As at April 2001, BGT's market share in the industrial and commercial gas market is approximately 16.1% by volume and 49.7% by sites supplied.

¹ As of 15 April 2001.

TotalFinaElf

4.4 TFE is a company that resulted from the merger between Total and PetroFina of Belgium in July 1999, and the subsequent merger of TotalFina with Elf Aquitaine, which was formalised in early 2000. Its principal business interests in the UK are:

- a) gas supply, through its three licensed companies Total Energy Gas Suppliers Ltd, Total Gas Marketing Ltd and TotalFinaElf Gas and Power Ltd;
- b) gas shipping, through five licensed companies, Elf Exploration UK plc, Elf Trading SA, TotalFinaElf Gas and Power Ltd, Total Gas Marketing Ltd and TotalFinaElf Exploration UK plc;
- c) gas transportation, through its PGT licensee TotalFinaElf Pipelines Limited; and
- d) gas production, operating fields in the North Sea.

TFE has recently applied for two second tier electricity supply licences (one for supplying electricity in England and Wales and the other for supplying electricity in Scotland). TFE supplies gas to approximately 90,000 domestic customers in Great Britain, representing a market share of 0.45%. Under its TotalFinaElf Gas & Power licence it supplies gas to approximately 21,500 industrial and commercial supply points, which represents 5.7% of that market in Great Britain.

South Humber Bank power station

4.5 South Humber Bank (Humber) power station is a 1260 MW combined cycle gas turbine power station at Stallingborough, in north-east Lincolnshire. The station was constructed in two phases. Phase I comprises three gas turbine generators with three associated heat recovery steam generators, and one steam turbine generator, with a combined capacity of approximately 750MW. Phase II comprises the combination of two gas turbine generators with associated heat recovery steam generators and one steam turbine generator, with a combined capacity of approximately 510MW.

4.6 Through wholly owned subsidiaries, Centrica and TFE will enter tolling agreements with HPL. Centrica will supply all the gas to HPL for the phase I plant and be entitled to its entire electricity generation capacity. TFE will do likewise with the phase II plant. HPL accounts for just under 2% of all the capacity available for generation of electricity in England and Wales. In 1999/2000 it produced 9,653GWh, or 3.2% of the generating output in England and Wales.

5. Issues arising from the proposed acquisition

Concentration of generation interests in Great Britain

- 5.1 Ofgem will need to consider whether the acquisition of HPL represents a concentration in the generation market of England and Wales. TFE has not been active in this market except for its previous 12.5% share in HPL, and this is Centrica's first acquisition in the generation market. Therefore, we do not believe that this transaction will result in an increase in concentration in the market. Any views are welcome.
- 5.2 As well as the completed acquisition of a 60% interest in HPL, which represents 750MW of capacity, Centrica also has a 50% interest in a project to develop the Spalding power station. Spalding will have a capacity of approximately 840MW, when completed, which would bring Centrica's cumulative capacity total to a possible 1170MW. Total installed capacity in England and Wales is 68GW, Centrica's cumulative market share would represent approximately 1.7% of this. Nonetheless, Ofgem may need to consider the accumulative effect of this capacity in the generation market.
- 5.3 Ofgem considers that there is scope for generators, who by normal competition standards have relatively low market shares, to manipulate the market and damage competition and/or harm customers. Ofgem considers that this is a result of the special features of the electricity market, including the inability to store electricity other than at very high cost the complexity of the market rules and the relatively inelastic demand and supply conditions, particularly close to real time.
- 5.4 At present there are limited regulatory safeguards against non-dominant companies manipulating the market in particular in relation to the potential gaming of transmission constraints, complex market rules or the withdrawal of generation capacity. Given these concerns, Ofgem will therefore have to carefully consider the impact of the transaction on competition in the wholesale electricity market.
- 5.5 The DTI have consulted on a proposed generation licence conditions regarding system balancing and capacity withdrawal. If the DTI introduces the proposed

licence conditions in generation licences, Ofgem will have regulatory safeguards against the manipulation of the wholesale markets.

Arbitrage

- 5.6 Given Centrica's position in the gas supply market, Ofgem will need to consider whether distortions in competition may arise as a result of arbitrage between the gas supply and electricity generation markets. Ofgem invites views on this issue.

Restriction on own generation capacity

- 5.7 In the past generation limits have been included in Public Electricity Supply (PES) licences to prevent vertically integrated companies with a captive customer base, purely supplying their own designated customers at excessive prices. In previous acquisitions, generation limits have been included in the PES licence, and restrictions on electricity sale contracts between designated supply and associated generation businesses have been considered. Neither TFE nor Centrica hold a PES licence in England and Wales. All customers who have switched to Centrica's electricity portfolio have been gained in a competitive environment and are free to choose an alternative electricity supplier. Accordingly, Ofgem does not consider that there is any need to protect the customers that Centrica has gained through competition. We welcome comments on the issue.

Vertical integration

- 5.8 In gas, Centrica is already a vertically integrated participant. Under this transaction Centrica will become a vertically integrated participant in the electricity market as well. Ofgem will be taking into account the possible impact of another vertically integrated company into the market. Centrica has approximately 14.7% of the Great Britain market for the retail supply of electricity and will be the third largest competitor in this market (after TXU Europe [including Norweb Energi] and Npower [including Yorkshire] and Scottish and Southern Energy in fourth position).
- 5.9 Ofgem will have to consider whether Centrica's vertically integrated position is likely to result in a leveraging of market power. Incumbent companies in the

electricity market, such as Centrica, may use their market power in one activity to reduce competition in another to the potential detriment of consumers. Ofgem will have to consider whether such concerns can be dealt with effectively through our existing powers under the Electricity Act 1989, the Gas Act 1986 and the Competition Act 1998.

Gas tolling arrangements

- 5.10 HPL will be supplied with gas under tolling agreements between Centrica and TFE. Ofgem will need to consider whether the tolling agreements give rise to any competition concerns, or whether they will be viewed as ancillary to the transaction.

6. Conclusion

- 6.1 Ofgem is seeking the views of interested parties on the acquisition of Humber Power Limited by Centrica and TFE, so that the Authority may make recommendations to the Director General of Fair Trading.
- 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 Comments on the proposed acquisition should be sent, by Tuesday 3 July 2001 to:

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